UNRELATED BUSINESS INCOME TAX

HEARINGS

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

JUNE 22, 25, 26, 29, AND 30, 1987

Part 2 of 3

JUNE 26 AND 29, 1987

Serial 100-27

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE
82-039 WASHINGTON : 1988

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

H781-17

82-039 0 - 88 - 1

COMMITTEE ON WAYS AND MEANS

DAN ROSTENKOWSKI, Illinois, *Chairman*

SAM M. GIBBONS, Florida
J.J. PICKLE, Texas
CHARLES B. RANGEL, New York
FORTNEY H. (PETE) STARK, California
ANDY JACOBS, Jr., Indiana
HAROLD FORD, Tennessee
ED JENKINS, Georgia
RICHARD A. GEPHARDT, Missouri
THOMAS J. DOWNEY, New York
FRANK J. GUARINI, New Jersey
MARTY RUSSO, Illinois
DON J. PEASE, Ohio
ROBERT T. MATSUI, California
BERYL ANTHONY, Jr., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
BARBARA B. KENNELLY, Connecticut
BRIAN J. DONNELLY, Massachusetts
WILLIAM J. COYNE, Pennsylvania
MICHAEL A. ANDREWS, Texas
SANDER M. LEVIN, Michigan
JIM MOODY, Wisconsin

JOHN J. DUNCAN, Tennessee
BILL ARCHER, Texas
GUY VANDER JAGT, Michigan
PHILIP M. CRANE, Illinois
BILL FRENZEL, Minnesota
DICK SCHULZE, Pennsylvania
BILL GRADISON, Jr., Ohio
WILLIAM M. THOMAS, California
RAYMOND J. McGRATH, New York
HAL DAUB, Nebraska
JUDD GREGG, New Hampshire
HANK BROWN, Colorado
ROD CHANDLER, Washington

Robert J. Leonard, *Chief Counsel*
M. Kenneth Bowler, *Staff Director*
A.L. Singleton, *Minority Chief of Staff*

Subcommittee on Oversight

J.J. PICKLE, Texas, *Chairman*

BERYL ANTHONY, Jr., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
HAROLD FORD, Tennessee
CHARLES B. RANGEL, New York
ANDY JACOBS, Jr., Indiana

DICK SCHULZE, Pennsylvania
BILL FRENZEL, Minnesota
WILLIAM M. THOMAS, California
RAYMOND J. McGRATH, New York

CONTENTS

Page
Press releases announcing the hearings 2

WITNESSES

U.S. Department of the Treasury, O. Donaldson Chapoton, Deputy Assistant Secretary (Tax Policy) 11
Internal Revenue Service, Hon. Lawrence B. Gibbs, Commissioner of Internal Revenue, and Robert I. Brauer, Assistant Commissioner for Employee Plans and Exempt Organizations 61
U.S. Small Business Administration, Frank S. Swain, Chief Counsel for Advocacy 89
U.S. General Accounting Office, Jennie S. Stathis, Associate Director, General Government Division 129

Alabama State Lodge, Fraternal Order of Police, Horace W. Hodges 1687
Alabama Symphony Orchestra, Edward Wolff 1146
Allen, Robert L., Consortium of University Film Centers 508
Alpha Therapeutic Corp., H. Edward Matveld and Edward A. Colton 1069
Altman, Steven, Texas A&I University, on behalf of American Association of State Colleges and Universities 396
Amador Corp., James Wm. Johnson 533
American Arts Alliance, William P. Blair, C. William Stewart, Edward Purrington, and Edward Wolff 1146
American Association of Museums, Willard Boyd, Mary Schmidt Campbell, Robert J. McQuarie, and Beverly Barsook 1109
American Association of Retired Persons, Cyril F. Brickfield 1620
American Association of State Colleges and Universities, Steven Altman 396
American Bar Association, Section of Taxation, John B. Jones, Jr 1737
American Bus Association, Susan Perry 640
American Clinical Laboratory Association, Harry Groome 818
American Council for the Arts, Laura Lee Blanton 1124
American Council of Independent Laboratories, Grover C. Williams 551
American Council on Education (and 18 other higher education associations), John DiBiaggio 359
American Healthcare Institute, Merlin K. DuVal, M.D 927
American Heart Association, Thom R. Winkler 1026
American Hospital Association, Jack W. Owen and John D. Leech 919
American Institute of Certified Public Accountants, Federal Taxation Executive Committee, Herbert J. Lerner 1749
American Red Cross, Lewellys F. Barker, M.D 1066
American Society of Association Executives, Roderick L. Geer 1633
American Society of Travel Agents, Inc., Earlene L. Causey 606
American Speech-Language-Hearing Association, Patricia R. Cole 1306
American Veterinary Medical Association, Alton F. Hopkins and Harold Knirk 741
Arena Stage, C. William Stewart 1146
Asher, Thomas M., HemaCare Corp 1082
Ashley, James W., YMCA of the USA 1189
Association of Governing Boards of Universities and Colleges, A.J. Pfister 1012
Association of Business Publishers, Stephen Feldman 1357
Association of Telemessaging Services International, Inc., Mark J. Golden 879
Association of the Bar of the City of New York, Committee on Nonprofit Organizations, Carolyn C. Clark 1756

Page
Association of Washington Business, Gerald R. Brong 523
Austin Center for Speech-Language-Learning Disorders, Patricia R. Cole 1306
Barker, Lewellys F., M.D., American Red Cross 1066
Barrett, Pat, United Way of America 1017
Barsook, Beverly, Museum Store Association, and American Association of Museums 1109
Beck, J. Edward, Jr., National Easter Seal Society 1034
Bennett, James T., George Mason University 1796
Berno, Donald C., United States Chamber of Commerce 327
Betts, Richard, YMCAs of Philadelphia, and YMCA of the USA 1195
Blair, William P., American Arts Alliance 1146
Blanton, Laura Lee, American Council for the Arts 1124
Boyd, Willard, Field Museum of Natural History, and American Association of Museums 1109
Brickfield, Cyril F., American Association of Retired Persons 1620
Brong, Gerald R., Association of Washington Business; and International Communications Industries Association 523
Bruce, Robert J., Widener University, on behalf of National Association of Independent Colleges and Universities 411
Business Coalition for Fair Competition, Joseph F. O'Neil, John Satagay, and Kenton Paddy 212
California Business Coalition, Alice Gallagher Reed 1394
Campbell, Mary Schmidt, Studio Museum in Harlem, and American Association of Museums 1109
Carlton, Donald M., Radian Corp., and Professional Services Council 581
Carr, Jeff, Vanderbilt University 416
Cascade Athletic Club, Frank Eisenzimmer 1219
Catholic Health Association, Sister Bernice Coreil 906
Causey, Earlene L., American Society of Travel Agents, Inc 606
Clark, Carolyn C., Committee on Nonprofit Organizations, Association of the Bar of the City of New York 1756
Cohen, Sheldon S., National Assembly of National Voluntary Health & Social Welfare Organizations 232
Cole, Patricia R., Austin Center for Speech-Language-Learning Disorders, and American Speech-Language-Hearing Association 1306
Colton, Edward A., Alpha Therapeutic Corp 1069
Consortium of University Film Centers, Robert L. Allen 508
Coreil, Sister Bernice, Catholic Health Association 906
Council on Research and Technology, Joseph A. Saloom 499
Cousins, Solon B., YMCA of the USA 1172
Crowson, James L., University of Texas System 1699
Cummings, Robert S., Massachusetts Society for the Prevention of Cruelty to Animals 735
Dale, Harvey P., New York University School of Law 1857
DiBiaggio, John, National Association of State Universities and Land-Grant Colleges, on behalf of the American Council on Education (and 18 other higher education associations) 359
Ducate, Douglas L., Society of Petroleum Engineers, and National Association of Exposition Managers 1712
DuVal, Merlin K., M.D., American Healthcare Institute 927
Eisenzimmer, Frank, Cascade Athletic Club, on behalf of the International Racquet Sports Association 1219
Family Service America, Geneva B. Johnson and Patricia A. Langley 1041
Feldman, Stephen, Association of Business Publishers 1357
Fellman, Steven J., Textile Rental Services Association of America, on behalf of Gerald S. Ostrow 823
Field Museum of Natural History, Willard Boyd 1109
Fiscal Planning Services, Stuart I. Rabinowitz 1329
Fraternal Order of Police, Illinois State Troopers Lodge No. 41, David Lumerman 1670
Fraternal Order of Police, State Lodge of Alabama, Horace W. Hodges 1687
Fremont-Smith, Marion R., Independent Sector 153
Gambardella, Frank, National Association of Portable X-Ray Providers 1335
Garber, Charles A., Structure Probe, Inc 1318
Garrett, Spencer, Pierpoint Racquet Club, on behalf of the International Racquet Sports Association 1250
Geer, Roderick L., Million Dollar Round Table, and American Society of Association Executives 1633

Page
Golden Mark J., Association of Telemessaging Services International, Inc 879
Gray, Bradford H., Institute of Medicine, National Academy of Sciences 995
Groome, Harry, American Clinical Laboratory Association 818
Grosvenor, Gilbert M., National Geographic Society 1609
Guenther, George C., Talmage Tours, Inc., and National Tour Association, Inc. 622
Hager, Susan, United Way of New York State, and United Way of America 1017
Hansmann, Henry, Yale Law School 1832
Hasson, James K., Jr., Sutherland, Asbill & Brennan, and Emory University 1816
Health Industry Distributors Association, Paul B. Simmons and Robert H. Wilbur 809
HemaCare Corp., Thomas M. Asher 1082
Hess, Earl H., United States Chamber of Commerce 327
Hodges, Horace W., Fraternal Order of Police, State Lodge of Alabama 1687
Holm, Robin, National Hearing Aid Society 793
Hopkins, Alton F., American Veterinary Medical Association 741
Howe, Jonathan T., National School Boards Association 1293
Hoyt, John A., Humane Society of the United States 745
Hughes, Kingdon R., Subsurface Library 1327
Humane Society of the United States, John A. Hoyt 745
Hutton, William T., Hastings College of the Law, University of California 730
Illinois State Troopers Lodge No. 41, Fraternal Order of Police, David Lumerman 1670
Independent Sector, Marion R. Fremont-Smith 153
Inman, Thomas E., II, Virginia Home Medical 866
International Communications Industries Association, Gerald R. Brong 523
International Racquet Sports Association:
    John McCarthy 1205
    Frank Eisenzimmer 1219
    Spencer Garrett 1250
International Taxicab Association, Jerilyn Nettnin 872
Johnson, Geneva B., Family Service America 1041
Johnson, James Wm., Amador Corp 533
Jones, John B., Jr., American Bar Association, Section of Taxation 1737
Jones, Linda Wolf, Nonprofit Coordinating Committee of New York 316
Jones, Ray, Texas Hearing Aid Association 1303
Kertz, Consuelo Lauda, Business School, Emory University 723
Knirk, Harold, American Veterinary Medical Association 741
Langley, Patricia A., Family Service America 1041
Leech, John D., American Hospital Association 919
Lehrfeld, William J., Shriners Hospitals for Crippled Children 935
Lerner, Herbert J., Federal Taxation Executive Committee, American Institute of Certified Public Accountants 1749
Littleton History Museum, Robert J. McQuarie 1109
Lumerman, David, Fraternal Order of Police, Illinois State Troopers Lodge No. 41 1670
Mason, Thomas, Notre Dame University, on behalf of National Association of College and University Business Officers 403
Massachusetts Society for the Prevention of Cruelty to Animals, Robert S. Cummings 735
Matveld, H. Edward, Alpha Therapeutic Corp 1069
Mayer, Robert, National Association of Small Business Against Hospital Unfair Competition 864
McCarthy, John, International Racquet Sports Association 1205
McQuarie, Robert J., Littleton History Museum, and American Association of Museums 1109
Michigan Humane Society, David K. Wills 753
Million Dollar Round Table, Roderick L. Geer 1633
Montrose Animal Health Center, Nolan P. Rubin 751
Motley, John J., III, National Federation of Independent Business 270
Museum Store Association, Beverly Barsook 1109
National Academy of Sciences, Institute of Medicine, Bradford H. Gray 995
National Assembly of National Voluntary Health & Social Welfare Organizations, Sheldon S. Cohen and W. Harrison Wellford 232
National Association of College and University Business Officers, Thomas Mason 403
National Association of Exposition Managers, Douglas L. Ducate 1712

Page
National Association of Independent Colleges and Universities, Robert J. Bruce 411
National Association of Portable X-Ray Providers, Frank Gambardella 1335
National Association of Regional Media Centers, Mark L. Richie 513
National Association of Small Business Against Hospital Unfair Competition, Robert Mayer 864
National Association of State Universities and Land-Grant Colleges, John DiBiaggio 359
National Easter Seal Society, J. Edward Beck, Jr 1034
National Federation of Independent Business, John J. Motley III and Abraham Schneier 270
National Geographic Society, Gilbert M. Grosvenor 1609
National Hearing Aid Society, Robin Holm 793
National School Boards Association, Jonathan T. Howe 1293
National Tour Association, Inc., George C. Guenther 622
Nettin, Jerilyn, International Taxicab Association 872
Nonprofit Coordinating Committee of New York, Peter Swords and Linda Wolf Jones 316
Notre Dame University, Thomas Mason 403
O'Neil, Joseph F., Business Coalition for Fair Competition 212
Ostrow, Gerald S. (*See* Textile Rental Services Association of America.)
Owen, Jack W., American Hospital Association 919
Paddy, Kenton, Business Coalition for Fair Competition 212
Perry, Susan, American Bus Association 640
Peterson, Eric C., United Bus Owners of America 634
Pfister, A.J., Association of Governing Boards of Universities and Colleges 1012
Pierpoint Racquet Club, Spencer Garrett 1250
Professional Services Council, Donald M. Carlton 581
Purrington, Edward, Washington Opera, and American Arts Alliance 1146
Rabinowitz, Stuart I., Fiscal Planning Services 1329
Radian Corp., Donald M. Carlton 581
Reed, Alice Gallagher, California Business Coalition 1394
Richie, Mark L., National Association of Regional Media Centers 513
Rose-Ackerman, Susan, Columbia University 1830
Rubin, Nolan P., Montrose Animal Health Center 751
Rudney, Gabriel, Institution for Social and Policy Studies, Yale University 985
Saloom, Joseph A., Council on Research and Technology 499
Sanford, Hon. Terry, a U.S. Senator from the State of North Carolina 353
Satagaj, John S., Small Business Legislative Council 1348
Satagay, John, Business Coalition for Fair Competition 212
Schneier, Abraham, National Federation of Independent Business 270
Seay, J. David, United Hospital Fund of New York 951
Shillingburg, J. Edward, Lord, Day & Lord 1845
Shriners Hospitals for Crippled Children, William J. Lehrfeld 935
Simmons, Paul B., Health Industry Distributors Association 809
Small Business Legislative Council, John S. Satagaj 1348
Society of Petroleum Engineers, Douglas L. Ducate 1712
Stark, Hon. Fortney H. (Pete), a Representative in Congress from the State of California 766
Stewart, C. William, Arena Stage, and American Arts Alliance 1146
Structure Probe, Inc., Charles A. Garber 1318
Studio Museum in Harlem, Mary Schmidt Campbell 1109
Subsurface Library, Kingdon R. Hughes 1327
Swords, Peter, Nonprofit Coordinating Committee of New York 316
Talmage Tours, Inc., George C. Guenther 622
Texas A&I University, Steven Altman 396
Texas Hearing Aid Association, Ray Jones 1303
Textile Rental Services Association of America, Steven J. Fellman on behalf of Gerald S. Ostrow 823
Trinity Engineering Testing Corp., Grover C. Williams 551
United Bus Owners of America, Eric C. Peterson 634
United Hospital Fund of New York, J. David Seay 951
United States Chamber of Commerce, Earl H. Hess and Donald C. Berno 327
United Way of America, Susan Hager and Pat Barrett 1017
United Way of New York State, Susan Hager 1017
University of Texas System, James L. Crowson 1699
Vanderbilt University, Jeff Carr 416
Virginia Home Medical, Thomas E. Inman II 866

Page
Washington Opera, Edward Purrington 1146
Webster, George D. Webster, Chamberlain, Bean & McKevitt 1801
Wellford, W. Harrison, National Assembly of National Voluntary Health & Social Welfare Organizations 212
Widener University, Robert J. Bruce 411
Wilbur, Robert H., Health Industry Distributors Association 809
Williams, Grover C., Trinity Engineering Testing Corp., and American Council of Independent Laboratories 551
Wills, David K., Michigan Humane Society 753
Winkler, Thom R., American Heart Association 1026
Wolff, Edward, Alabama Symphony Orchestra, and American Arts Alliance 1146
YMCA of the USA:
    Solon B. Cousins 1172
    James W. Ashley 1189
    Richard Betts 1195
YMCAs of Philadelphia, Richard Betts 1195

SUBMISSIONS FOR THE RECORD

ADAPSO, George T. DeBakey, statement 1880
Airport Limousine Service Inc., James L. Sunstein, letter 1882
Allen, William E., D.D.S., American Dental Association, letter 1886
American Bankers Association, statement 1883
American Collectors Association, John W. Johnson, statement 1638
American Dental Association, William E. Allen, D.D.S., letter 1886
American Diabetes Association, Inc., statement 1895
American Legion, Robert W. Spanogle, statement and attachments 1901
American Medical Association, statement 1917
American Society for Personnel Administration, statement 1922
American Society of Association Executives, John W. Johnson, statement 1638
Andrews, Martha A., Businesses and Associations for a Strong Economy, letter and attachments 1968
Applied Research Associates, Paul O. Davis, letter 1926
Arizona Hearing Aid Society, K. Ray Katz, letter and attachment 1928
Aronofsky, David J., Earl W. Kintner, Michael D. Barnes, and Marc L. Fleischaker, National Association of College Stores, joint letter 2222
Audio Hearing Aid Center, Inc., Lawrence J. House, letter 1931
Audio Prosthetics, Samuel I. Kiser, letter 1932
Audiologic Services, Albert P. Silverio, letter 1933
Bakalars, Edward J., La Crosse Hearing Aid Center, letter 2198
Bankers Committee for Tax Equality, statement 1934
Barnes, Michael D., Earl W. Kintner, Marc L. Fleischaker, and David J. Aronofsky, National Association of College Stores, joint letter 2222
Bartolucci, John, Beltone Hearing Aid Service, Springfield, Mass., letter 1953
Beltone Hearing Aid Center:
    Ervin E. King, Billings, Montana, letter and attachment 1940
    Karen S. Maas, Traverse City, Michigan, letter and attachments 1942
    Eules T. Morgan, Florence, S.C., letter 1949
    James Ogurek, Ogurek Enterprises, Inc., Wausau, Wisconsin, letter 1950
Beltone Hearing Aid Service:
    John Bartolucci, Springfield, Mass., letter 1953
    James A. Bohren, Sheboygan, Wisconsin, letter and attachments 1956
    William E. King, Pittsburgh, Pa., letter and attachment 1963
    Richard Pitt, Statesboro, Georgia, letter 1965
    Curt Wallis, Peggy Wallis, J. Michael Wallis, Josh Villasenor, and Karen W. Villasenor, Odessa, Texas, joint letter 1966
Bethlehem Hearing Aid Center, Thomas R. Stephens, letter 1967
Boehlert, Hon. Sherwood, a Representative in Congress from the State of New York, and Hon. Bob Wise, a Representative in Congress from the State of West Virginia, joint letters 2356
Bohren, James A., Beltone Hearing Aid Service, Sheboygan, Wisconsin, letter and attachments 1956
Bollinger, Terry, Mid-Kansas Acousticon, Inc., letter 2220
Businesses and Associations for a Strong Economy, Martha A. Andrews, letter and attachments 1968

Page

Cappabianca, Hon. Italo S., Select Committee to Study Business Activities of Nonprofits, Pennsylvania House of Representatives, statement and attachment 1726
Carter, Rev. James C., Loyola University, statement 2200
Catholic Charities USA, statement 2145
Christensen, Elfreda, Elfreda Christensen Hearing Aids, letter 2152
Cook-Witter, Inc., Randall F. Witter, letter 2153
Councilman, Dorothy, Hearing Aid Center, letter and attachments 2177
Davis, Paul O., Applied Research Associates, letter 1926
DeBakey, George T., ADAPSO, statement 1880
Dewey, Ballantine, Bushby, Palmer & Wood, statement 2154
Drake Hearing Aid Center, Timothy L. Drake, letter 2158
Eaneman, Robert G., Volunteer Trustees of Not-For-Profit Hospitals, statement 2353
Edwards, Wade H., Florida Hospital Association, Inc., letter 2163
Erie Audiology & Hearing Aid Center, Neal E. Mann, letter 2161
Evans, Sam, YMCA, National Board, statement 1202
Fishman, Joseph D., New Jersey Guild of Hearing Aid Dispensers, letter 2288
Fleischaker, Marc L., Earl W. Kintner, Michael D. Barnes, and David J. Aronofsky, National Association of College Stores, joint letter 2222
Florida Chiropractic Association, Inc., Ed Williams, letter 2162
Florida Hospital Association, Inc., Wade H. Edwards, letter 2163
Galles, John Paul, National Small Business United, statement 2284
Gillum, Charlie, Charlie Gillum United Hearing Aid Service, letter 2164
Goodwill Industries of America, Inc., statement 2165
Greene, Cary W., Hearing Aid Specialists, letter 2181
Hackett, Stanley H., Jebco, Inc., letter 2188
Hammond, Dean, Hammond, Inc., on behalf of U.S. Cartographic Industry Members, statement and attachments 2345
Haspel, Donald P., National Office Products Association, statement 2282
Haviland Hearing Aids, Richard H. Haviland, letter 2175
Healthcare Financial Managment Association, statement 2182
Hearing Aid Associates, William J. and Dolores P. Kemple, joint letter 2176
Hearing Aid Center, Dorothy Councilman, letter and attachments 2177
Hearing Aid Specialists, Cary W. Greene, letter 2181
Hieb, Carol J., Statewide Hearing Aid Center, letter and attachments 2328
Hospital Trustees of New York State, statement 2185
House, Lawrence J., Audio Hearing Aid Center, Inc., letter 1931
Jebco, Inc., Stanley H. Hackett, letter 2188
Johnson, John W., American Collectors Association, and American Society of Association Executives, statement 1638
Katz Hearing Aid Center, Kalman R. Katz, statement and attachment 2191
Katz, K. Ray, Arizona Hearing Aid Society, letter and attachment 1928
Kemple, William J., and Dolores P., Hearing Aid Associates, joint letter 2176
Kerr, Jeannette, MAICO Hearing Aid Service, letter 2209
King, Ervin E., Beltone Hearing Aid Center, Billings, Montana, letter and attachment 1940
King, William E., Beltone Hearing Aid Service, Pittsburgh, Pa., letter and attachment 1963
Kintner, Earl W., Michael D. Barnes, Marc L. Fleischaker, and David J. Aronofsky, National Association of College Stores, joint letter 2222
Kiser, Samuel I., Audio Prosthetics, letter 1932
La Crosse Hearing Aid Center, Edward J. Bakalars, letter 2198
Lake, F. David, Jr., University Patents, Inc., statement 2342
Lifset, Reid J., Department of Political Science, Massachusetts Institute of Technology, statement and attachment 2210
Loyola University, Rev. James C. Carter, statement 2200
Maas, Karen S., Beltone Hearing Aid Center, Traverse City, Michigan, letter and attachments 1942
MAICO Hearing Aid Service, Jeannette Kerr, letter 2209
Mann, Neal E., Erie Audiology & Hearing Aid Center, letter 2161
Mattox, Hon. Jim, Attorney General, State of Texas, letter 2336
Mertz, George J., National Industries for the Blind, statement 2272
Mid-Kansas Acousticon, Inc., Terry Bollinger, letter 2220
Miller, C.L. "Kip", and Elizabeth "Betty", Orange Hearing Aids, joint letter 2298
Morgan, Eules T., Beltone Hearing Aid Center, Florence, S.C., letter 1949
Murphy, Robert, Statewide Hearing Aid Center, letter and attachments 2334

Page
National Association of College Stores, Earl W. Kintner, Michael D. Barnes, Marc L. Fleischaker, and David J. Aronofsky, joint letter 2222
National Association of Home Builders, statement 2238
National Association of Retail Druggists, John M. Rector, letter and attachments 2241
National Industries for the Blind, George J. Mertz, statement 2272
National Office Products Association, Donald P. Haspel, statement 2282
National Small Business United, John Paul Galles, statement 2284
National Society of Professional Engineers, Donald G. Weinert, letter 2286
New Jersey Guild of Hearing Aid Dispensers, Joseph D. Fishman, letter 2288
Novak Hearing Center, Charles J. Novak, letter 2291
Ogurek, James, Ogurek Enterprises, Inc., Beltone Hearing Aid Center, Wausau, Wisconsin, letter 1950
Oliver, Daniel, Federal Trade Commission, statement 2293
Orange Hearing Aids, C. L. "Kip" and Elizabeth "Betty" Miller, joint letter 2298
Pitt, Richard, Beltone Hearing Aid Service, Statesboro, Georgia, letter 1965
Pennsylvania House of Representatives, Select Committee to Study Business Activities of Nonprofits, Hon. Italo S. Cappabianca, statement and attachment 1726
Powell, R. K., Silver Spring, Maryland, letter 2299
Rector, John M., National Association of Retail Druggists, letter and attachments 2241
Schauer Hearing Aid Center's of North Dakota, Floyd Schauer, et al, joint letter and attachments 2305
Silverio, Albert P., Audiologic Services, letter 1933
Society of National Association Publications, statement 2316
Society of the New York Hospital, statement 2318
Spanogle, Robert W., American Legion, statement and attachments 1901
Statewide Hearing Aid Center, Great Falls, Montana:
    Carol J. Hieb, letter and attachments 2328
    Robert Murphy, letter and attachments 2334
Stephens, Thomas R., Bethlehem Hearing Aid Center, letter 1967
Sunstein, James L., Airport Limousine Service Inc., letter 1882
Texas, State of, Hon. Jim Mattox, Attorney General, letter 2336
U.S. Cartographic Industry Members, Dean Hammond, Hammond, Inc., statement and attachments 2345
University Patents, Inc., F. David Lake, Jr., statement 2342
Villasenor, Josh and Karen W., Beltone Hearing Aid Service, Odessa, Texas, joint letter 1966
Volunteer Trustees of Not-For-Profit Hospitals, Robert G. Eaneman, statement 2353
Wallis, Curt, J. Michael, and Peggy, Beltone Hearing Aid Service, Odessa, Texas, joint letter 1966
Weinert, Donald G., National Society of Professional Engineers, letter 2286
Williams, Ed, Florida Chiropractic Association, Inc., letter 2162
Wise, Hon. Bob, a Representative in Congress for the State of West Virginia, and Hon. Sherwood Boehlert, a Representative in Congress from the State of New York, joint letters 2356
Witter, Randall F., Cook-Witter, Inc., letter 2153
Woodard Hearing Aid Centers, Paul E. Woodard, letter and attachment 2359
YMCA, National Board, Sam Evans, statement 1202
Young's Hearing Aid Service, G. Charles Young, letter 2361

UNRELATED BUSINESS INCOME TAX

FRIDAY, JUNE 26, 1987

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, DC.

The subcommittee met, pursuant to call, at 9 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

Chairman Pickle. The Chair will ask the meeting to come to order.

We have a full day consisting of seven panels, so I know everybody will want to cooperate so we can have a complete record.

The Subcommittee on Oversight begins its third day of hearings on the unrelated business income tax. Questions have been raised about the UBIT for which the subcommittee needs answers.

Is the tax being administered properly and aggressively? Is the law having its intended effect of preventing tax-exempt organizations from engaging in commercial activities to the detriment of for-profit business? Is there compliance with the law? Is the intent of UBIT being circumvented through joint ventures, partnerships, or allocation of income and expenses between nonprofit and for-profit subsidiaries?

We received excellent testimony from government agencies, especially from the Department of the Treasury, as well as from universities, representatives of research, travel and veterinary services, and numerous others concerned about the UBIT.

Today, I ask each witness to tell this subcommittee what you think about the legislative suggestions that the Department of the Treasury made to the subcommittee on Monday. Further, I expect each witness, as part of their testimony, to give me specific and factual answers to questions such as:

For the tax-exempt groups: On what types of income-producing activities do you—and your member organizations—pay UBIT? What is the amount of income that is taxed, and how much tax was paid? What are your major sources of income that are excluded or exempted from UBIT, and in what amounts?

And from the for-profit groups: What specific nonprofit income-producing activities have caused you—and your member organizations—harm through unfair competition? Exactly what is the unfair competition? Which nonprofit organizations are engaging in these activities, and to what extent?

These questions must be answered in full if the subcommittee's oversight review of UBIT is to be complete. Only you the witnesses have the information and the answers. I ask that you summarize your testimony in three to four minutes and be as responsive as you can. If the questions we will raise will be too long in answering, we ask you to submit to us in writing the answer to those questions so our record will be complete.

We are privileged first to hear from the Honorable Pete Stark of California, our colleague.

Before we recognize you, Mr. Stark, may I ask my colleague, Mr. Schulze, if he has any opening statement.

Mr. SCHULZE. Thank you, Mr. Chairman.

I am pleased to join you in continuing our hearings on the unrelated business activities of tax-exempt organizations. Yesterday, we received valuable testimony regarding university research and bookstore activities, travel service competition and animal care.

We heard specific examples of alleged unfair competition by university bookstore operations and nonprofit testing laboratories. The evidence we receive will be helpful in shaping our debate on the UBI issue. Today we will focus on the health care sector and the special situation of museums. The growing area of contention is the proper role of nonprofit hospitals in providing medical equipment for use outside of the hospital. For example, some persons claim that the sale of hearing aids by nonprofit hospitals is resulting in unfair competition with for-profit hearing centers. Other persons claim that nonprofit hospitals have expanded their pharmacy operations in a way which unfairly intrudes into the market of traditional for-profit drug stores.

I am anxious to learn more about these claims. We will also hear from the museum community. While museums historically have had a very conservative staid image, some museums are expanding their services and fundraising activities in new ways. For example, once quiet museum gift shops have grown into nationwide large-scale gift catalog operations. We can benefit by learning more about the special situation of these museums.

Mr. Chairman, I am looking forward along with you in receiving today's testimony.

Chairman. PICKLE. Thank you, Mr. Schulze.

Now, Mr. Stark, we will be pleased to hear from you.

STATEMENT OF HON. FORTNEY H. (PETE) STARK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. STARK. Thank you, Mr. Chairman, and in the spirit of the Chair's interest in brevity, I have a 3 or 4 minute presentation that shouldn't take me much more than a half an hour. If I may direct the committee's attention directly to the reason for tax-exempt status, particularly for nonprofit hospitals.

The issue of what is a reasonable return to a community, the State and Nation and the local municipality, is an issue that begs the whole question as to the purpose or mission of health and medical care in the country. The historic purpose of hospitals is to give comfort and shelter to the sick, regardless of financial status. All early hospitals in this country were supported entirely by charity. As the Chair and the members well know, this mission has become clouded by a marketplace free enterprise approach to problem solving, and those of us who work with Medicare have heard from 6,000 hospitals which is all the hospitals in the country, and each one is going bankrupt next year unless we give them more money in the Medicare system.

But if you look at the facts, that is hardly the case.

These oversight hearings give us an excellent opportunity to look at the history of why a hospital should have a not-for-profit exemption in the first place, and to raise the very real question of whether they should continue to have it. There is a substantial amount of data that we ought to cancel the not-for-profit exemption for hospitals and let them deduct 2 or 3 times their charitable contributions, because if you look at the record, the overall charitable contribution of the hospital industry is miserable. For many it's absolutely nonexistent.

I would like to bring to the subcommittee's attention and I would ask that it be submitted in its entirety for the record, a study produced by a group sponsored by the schools of public health at the University of California in Berkeley and using data from the California Health Facilities Commission. The study shows the value of uncompensated care provided by California nonprofit hospitals. In 1984 to 1985 it was $82 million compared to a combined local, State, and Federal tax exemption of $300 million.

In other words, for every dollar of charity care in California, we gave away $4 in tax exemption. What I hope the committee will ask each hospital, each medical care provider as they testify today, is how many dollars of charitable care did you provide and how much tax did you provide in real estate tax, in local sales tax, in State income tax, in Federal income tax, because I think that will get the message to the industry that they are in a profit-making mode and indeed if we are going to exempt them from the tax system, it is our duty to see that the community gets medical care for its dollar of tax forgiven, foregone, or rebated.

California is somewhat unique in that it keeps records on all of its hospitals which are available and it does it by group. I think another interesting statistic is that an estimate of 1986 based on very similar figures for 1982, 1983, 1984, and 1985, which I have, shows that out of a total gross revenue—and you can take that revenue because that is perhaps a better measure—of $10 billion, there was less than $60 million of charitable care or less than four-tenths of 1 percent of their net revenues were for charitable care. This is only for the nonprofit hospitals. For-profits didn't do better.

What I am suggesting is that this is not an adequate record. We all know the push to restrain the Federal deficit and that we should look to this industry to do their share.

I would be happy to answer any questions that the panel has and I want to commend the Chair and the members for delving into this very complicated and difficult subject. I hope I can be of some help.

[The statement of Mr. Stark and attachment follow:]

STATEMENT OF CONGRESSMAN FORTNEY H. (PETE) STARK
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
JUNE 26, 1987

TAX EXEMPTION AND THE HEALTH INDUSTRY

Mr. Chairman, Members of the Committee:

Thank you for the opportunity to testify.

I would like to bring to the Subcommittee's attention a recent study that is of interest to these deliberations. It is a paper prepared by the Western Consortium for the Health Professions, Inc., a group sponsored by the Schools of Public Health & University Extensions of UC-Berkeley.

This study used data from the California Health Facilities Commission to examine the value of uncompensated care provided by California nonprofit community hospitals in 1984-85. These hospitals reported $82 million in uncompensated care compared to an estimated combined local, State, and Federal tax exemption of $300 million. The authors of the study caution about the precision of the numbers, but do raise several timely questions about how we measure, how we determine, the appropriate return to a community for a tax-exempt status.

Although this study or snap shot is provocative in its implication about our hospitals, I am convinced it does not sufficiently explain what is happening out there. Snap shots are merely two-dimensional representations. What we need is a multi-dimensional description, a hologram in fact, of our nation's hospitals. Clearly, most not-for-profit hospitals return more to their communities than just what is measured in uncompensated care costs on the bottom line--and we need to measure the full range of their contribution.

Still, the information suggests that many communities around the country may not receive an equitable return from the local not-for-profit hospital in exchange for its tax exempt status. Do we have truly charitable institutions, or not-for-profit operations cruising by on an unjustifiable public subsidy?

Those in the hospital community will tell you I'm not in favor of the for-profit hospital movement. In fact, I'm against it. The deeply historic purpose of hospitals, indeed of all medical care, is to give treatment and comfort to the sick and dying. It is not to make a profit on someone's illness. This historic purpose, this mission, is now very clouded by a marketplace, pro-competitive approach to solving our problems of escalating costs.

But while I question the move to for-profit hospitals, I am also in favor of tax reform and for the much cliched "level playing field." Therefore, if tax-exempt, not-for-profit hospitals are not providing enough service to the community to justify the costs to society of their tax exemption, then they should show their true colors, end the subsidy, and convert to for-profit.

Medicare needs to do more to help hospitals that provide large amounts of uncompensated, charity care. If we can better understand the value of public service provided by hospitals compared to the subsidies they receive, we can better target Medicare's disproportionate share program toward those who really deserve the help, because they give the help.

If those who do not provide adequate levels of charity care and community service, in the broadest definition, were to pay taxes, we could use those tax revenues to compensate those who have remained true to the original purposes of the hospital.

I will work with my Health Subcommittee to improve support of the true charity givers, and I hope you can encourage the same policy through the tax code.

WESTERN CONSORTIUM FOR THE HEALTH PROFESSIONS, INC.
703 Market Street, Suite 535, San Francisco, California 94103
/415/546-7601 · Cable: WESCONSORT

NONPROFIT COMMUNITY HOSPITAL TAX EXEMPTION: ISSUES FOR REVIEW

ABSTRACT: Nonprofit community hospitals receive local, state, and federal tax subsidies in the form of exemption from ad valorem property taxes and state and local income taxes. Tax exemption for hospitals reflects a public judgement that the cost of tax revenues foregone is less than the value to the community of services provided by the hospital in return for the exemption. The nature of the hospital services for which exemption is granted has been defined as charitable services relieving governmental burdens and enhancing community values and goals, or simply as the provision of modern hospital services. Although there is widespread public concern over the provision of indigent care by community hospitals and support for establishment of ownership-neutral incentives to hospital efficiency, nonprofit community hospital applications for tax exemption are routinely granted in most jurisdictions. This article compares non-profit community hospital uncompensated charity care levels with tax revenues foregone as a consequence of tax exemption. In 1984-85, California nonprofit community hospitals provided $82 million in uncompensated charity care. During that period, federal and state income and property tax revenues lost as a result of tax exemption were $300 million. Aggregate figures such as these should be interpreted with caution, since they do not represent the experience of any individual hospital, nor account for community services other than uncompensated charity care which hospitals may provide. Nevertheless, they suggest the need for further examination of the community service contribution of tax-exempt hospitals in the current competitive hospital environment.

James B. Simpson, J.D., M.P.H. and Diane M. Lee
Western Center for Health Planning
Western Consortium for the Health Professions

NONPROFIT COMMUNITY HOSPITAL TAX EXEMPTION: ISSUES FOR REVIEW

James B. Simpson, J.D., M.P.H.* and Diane M. Lee**
Western Center for Health Planning
Western Consortium for the Health Professions

May 1987

This report was prepared for the Inland Counties Health Systems Agency by the Western Center for Health Planning. The Western Center is a program of the Western Consortium for the Health Professions. It receives support from the U.S. Dept. of Health and Human Services to provide technical assistance to state and local health planning agencies such as ICHSA under the National Health Planning and Resources Development Act.

The Western Center was asked by ICHSA to prepare a report setting forth:

- An overview of California law regarding nonprofit community hospital tax exemption.
- Comparisons of levels of uncompensated charity care provided by nonprofit community hospitals with tax revenues lost as a consequence of various exemptions.
- Discussion of substantive arguments that might be raised in a lawsuit challenging the entitlement of a nonprofit community hospital in California to property tax exemption.
- Discussion of legislative options to clarify the indigent care obligation of tax-exempt nonprofit community hospitals.

---

* General Counsel, Western Consortium; Director, Legal Resources Program, Western Center for Health Planning.

**Research Associate, Western Center for Health Planning; 2nd-year student, University of California, Berkeley (Boalt Hall) School of Law.

This project has been funded with Federal Funds from the Health Resources Administration, Department of Health and Human Services, under contract HRA-232-79-0039. The contents of this publication do not necessarily reflect the view or policies of the Department of Health and Human Services, nor does mention of trade names, commercial products, or organizations imply endorsement by the U.S. Government.

Section I of the report contains background information on property and income tax exemptions for nonprofit community hospitals, including a comparison of the tax revenue loss occasioned by such exemptions with the level of uncompensated charity care provided by such institutions. Section II contains an analysis of legal theories under which the property tax exemption of a California nonprofit community hospital with a relatively low level of charity care might be challenged. Section III contains suggestions for further research, and for amending the legal standards for granting an exemption in order to link exemption more closely to provision of a reasonable volume of uncompensated charity care.

I. BACKGROUND OF THE TAX EXEMPTION

The Property Tax Exemption

Property taxes are a major source of local government revenue throughout the U.S. The power of state and local governments to levy property taxes has traditionally been limited by state constitutional and statutory provisions exempting certain property from taxation. The great majority of state constitutions or statutes contain some form of property tax exemption for charitable and related institutions, including nonprofit community hospitals.[1]

State property tax exemptions vary widely. For example, Oregon's Constitution authorizes the legislature to impose uniform tax assessments; a state statute providing for property taxes contains an exemption for "literary, benevolent, charitable and scientific institutions", a phrase which presumably includes hospitals qualifying under one of its terms.[2] The Washington Constitution authorizes the legislature to exempt any property from taxation; a statute exempts property of nonprofit hospitals.[3] Arizona's Constitution permits exemption of property of nonprofit educational, religious, or charitable institutions; a statute exempts "hospitals and other charitable institutions for relief of the indigent of afflicted."[4]

California's law grants a more explicit and specific exemption from property taxes for hospitals than most state laws. The California Constitution provides:

[1] 71 AM.JUR.2d STATE AND LOCAL TAXATION §362 (1973).

[2] ORE CONST. ART IX, Sec. 1; ORE. REV. STAT. §307 (1985 Rpl.Part).

[3] WASH. CONST. ART 7, §2; R.C.W. 84.36.040 (1986 Cum. Supp.).

[4] ARIZ. CONST. ART 9, §2; A.R.S.§42-271 (1986 Supp.).

> The legislature may exempt from property taxation in whole or in part:...
>
> (b) property used exclusively for religious, hospital, or charitable entities: (1) that are organized and operated for those purpose, (2) that are nonprofit, and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual.[5]

This provision authorizes, but does not require, the legislature to exempt property used for hospital purposes. The legislature has exercised the authority granted it under Article XIII by adopting a basic enabling statute exempting religious, hospital scientific or charitable property: CA. REV. & TAX CODE §214.[6]

The Income Tax Exemption

In addition to exemption from property tax, charitable and related institutions such as nonprofit community hospitals are eligible for exemption from federal and state income or franchise taxes. Gifts they receive may also be tax deductible by the donor. Generally, such institutions are entitled to exemption from federal income tax under Internal Revenue Code Section 501(c)(3) and state income tax under state tax code provisions comparable to Section 501(c)(3). In California, the relevant tax code provision is California Rev. and Tax. Code §2370(d).

Briefly stated, to obtain federal tax exemption under 501(c)(3) a nonprofit organization such as a hospital must (1) be organized for one or more of the following stated purposes: religious, charitable, scientific, testing for public safety, literary or educational; (2) be organized and operated exclusively for one or more of the above exempt purposes; (3) have its assets irrevocably dedicated to an exempt purpose; (4) assure that no part of its net earnings inure to the benefit of private shareholders or individuals; (5) establish that it is not organized or operated for the benefit of private interests; and (6) satisfy certain limitations on lobbying and political campaign activities.

Underlying Basis for Exemption

Two rationales for exemption of charitable and other institutions such as nonprofit community hospitals from property and income taxes are commonly suggested by legal commentators and the courts. The first is that the exemption is granted in return for performance by the institution of services the State would otherwise be obliged to perform. The second is that the exemption is a reward for performance of activities that enhance beneficial community values and goals.

---

[5] CA. CONST. ART XIII, §4(b).

[6] Section 214 is set forth in Appendix "A" to this report.

Two points should be made with respect to these grounds for exemption. First, the basis for both is an exchange in which the State grants the exemption in return for something of value received by society from the institution. In the case of the "relieving governmental burden" rationale, the institution's activities substitute for government functions and services. In the case of the "community benefit" rationale, private activities augment or enhance government services. Second, both rationales look to the actual operations of the institution claiming exemption, not merely its organizational form, for their application.

In practice, the constitutional and statutory provisions that codify the property and income tax exemption for charitable and related institutions may not clearly express these principles. For example, the California Constitution simply exempts "property used exclusively for religious, hospital, scientific, of charitable purposes," without further specifying what "exclusive use" and "hospital" or "charitable" purposes entail. Other states' laws may be equally indefinite.

When constitutions or statutes contain language whose meaning is imprecise, or not self-defining, the task eventually devolves on the courts to discern their meaning. There is a substantial body of case-law from throughout the U.S. interpreting tax exemption provisions as they apply to nonprofit, community hospitals. Although there are significant exceptions, it is fair to say that the majority of these cases appear to stand for the proposition that an institution which: (1) offers hospital services to the general public; (2) is organized as a nonprofit corporation; and (3) satisfies certain limitations on private benefit, lobbying, etc. is entitled to an exemption.[7]

In our view, these characteristics are not necessarily sufficient to demonstrate that an institution is relieving governmental burdens or providing community benefits. The first can be met equally readily by nonprofit and proprietary hospitals. The second and third relate primarily to the avoidance of private distribution of profits. We think that tax exemption in fact requires something in the way of a manifest corporate mission to serve the public beyond the mere agreement to forego distribution of profits. Certainly the nonprofit hospital sector has never characterized its role in so narrow a sense, and we doubt that the public conception of a nonprofit community hospital is so limited.

---

[7] 71 AM.JUR2d STATE AND LOCAL TAXATION §385 (1973). *See, e.g.*, *Evangelical Luth. Good Sam. Soc. v. County of Gage* 151 N.W.2d 446,449 (Neb. 1967) ("Hospitals operated as nonprofit institutions are universally classed as charitable institutions".)

We believe that the court decisions which seem to announce a limited view of the public benefit required of nonprofit community hospitals in fact reflect a historical assumption by courts and legislatures that all hospital institutions which assume the nonprofit form and forego profit-making behavior undertake functions and services which relieve the burdens of government and serve the community to an extent generally commensurate with the tax revenues foregone as a consequence of the exemption. Courts, in particular, often entertain such presumptions where the costs of a more searching empirical inquiry are high and the presumption is logically founded and almost always correct. If this is the case, we believe that recent changes in the hospital business environment and evidence of the costs and benefits of the tax exemption in dollar terms make it appropriate to reexamine the correctness of the presumption.

Revenue Loss from Tax Exemptions

The nonprofit community hospital tax exemption results in a substantial loss in revenues to local, state, and federal government. We estimate that the annual revenue loss to local governments in California from the property tax exemption for nonprofit community hospitals is in excess of $61 million dollars.[8] In Los Angeles County the estimated revenue loss is approximately $22 million. In San Bernardino and Riverside Counties the loss is $2,750,000 and $1,340,000 respectively.

As noted above, in addition to being exempt from local property taxes, nonprofit community hospitals are exempt from federal and state income taxes. We estimate that in California the annual federal tax revenue foregone as a result of the nonprofit community hospital income tax exemption is approximately $198 million. Annual state income tax revenue foregone is approximately $41 million.[9]

---

[8] This figure was calculated by applying the 1985-86 California property tax rate of one-percent of assessed valuation to the total exempt value of hospitals in the state ($6,115,522,000). Source: COUNTY SUPERVISORS ASS'N. OF CALIF. CALIFORNIA COUNTY FACT BOOK 1985. The acutal revenue loss may be larger, since assessors are unlikely to devote a major effort to carefully monitoring the value of exempt property.

It is important to recognize the extent to which our figures relating to income taxes are estimates rather than exact measures of the tax loss, both in past and future years. Tax revenues which would actually be received by state and federal governments if the income tax exemption were not in place could be substantially different. There are several sources of potential error in the estimation method. First, we treat net revenues from operations as reported to the California Office of Statewide Health Planning and Development as equivalent to taxable income. Taxable income may not be identical to net revenues from operations as calculated the health facility data reporting system. Second, by using net revenue from operations we exclude net revenue from non-patient care activities. Some such revenue would be taxable income if exempt hospitals were taxed. If our figures for 1984-85 hospital revenue from operations were augmented by hospital net non-operating revenue, total revenues would increase by $251 million to $682 million. Estimated federal income tax revenues foregone would increase by $116 million to $314 million. Estimated state tax revenues foregone would increase by $24 million to $65 million. Third, by calculating tax revenues foregone on the aggregate net revenues of all California hospitals we overestimate by ignoring the effect of graduated tax rates on facilities with taxable income below $1,405,000. However, we also underestimate by allowing unused deductions from one facility to offset gross income from another facility. Additionally, our calculations assume that the behavior of exempt hospitals and other persons would remain unchanged if such facilities were taxable. In fact, one would expect the level of contributions to such institutions to diminish, and the management and financial affairs of the institutions to change in ways designed to avoid or reduce tax liability. Finally, we note that the maximum federal corporate income tax rate was reduced somewhat by the 1986 Tax Reform Act.

When combined, the California and federal income tax exemption results in lost tax revenues from nonprofit community hospital operations of $239 million. Thus, the combined income and property tax revenue loss from the nonprofit community hospital tax exemption is $300 million in California, with $102 million of that revenue loss borne by California government at the state and local level.

---

[9] These estimates are calculated as follows: For the federal taxes, the maximum federal corporate income tax rate (46% of taxable income exceeding $1,405,000) for 1985 was applied to 1984-85 California nonprofit hospital net revenues from operations of $431,818,284. Source: California Office of Statewide Health Planning and Development, Aggregate Hospital Financial Data for California (report periods ending June 30, 1984-June 29, 1985). For State taxes the state corporate income tax rate (9.6% of taxable income) was applied to 1984-85 California nonprofit hospital net revenues.

Indigent Care

There is increasing recognition that medical indigency is a serious social welfare problem in the U.S.[10] To some extent concern with the medically indigent simply reflects a revival of interest in a perennial problem. Substantial numbers of people have long been uninsured or inadequately insured, and ineligible for social insurance or medical benefit programs. They are often persons who are sporadically employed, or employed in industries where health insurance is not offered as an employee benefit. They may also be indigent persons who are not categorically eligible for Medicare or Medicaid or whose income falls just above eligibility maximums. Nonprofit community hospitals' uncompensated charity care consists of the provision of hospital services to such persons without charge or at a reduced charge.

Although uncompensated care and medical indigency are a long-standing problem, concern about them has markedly increased recently because of changes in the medical marketplace. First, by rewarding efficient patient care operations and penalizing costly producers in order to make the institutional health care delivery system more price-competitive, Medicare, Medicaid, and private payors have engineered reductions in the amount and/or rate of increase in payments to hospitals. In doing so, they may have reduced the ability and willingness of such facilities to provide uncompensated charity care. For the 1984-85 period, the value of charity care provided by all nonprofit community hospitals in California was less than one percent of their gross revenues.[11] Second, because of reduced state/federal revenue sharing and reductions in local tax revenue, the revenues of local governments have been sorely pressed to meet the costs of providing care to indigent persons in local government health facilities.

As a consequence of public concern with medical indigency, there has been considerable debate over mechanisms for providing hospital services to the medically indigent. Alternatives range from expansion of existing welfare programs to establishment of indigent care pools or special state-administered accounts for payment of indigent care, funded out of taxes on insurance premiums or hospital revenues.

The issue of uncompensated charity care provided by nonprofit community hospitals is logically a part of the indigent care financing debate. The tax exemption for nonprofit community hospitals is the original indigent care financing mechanism. Before society moves to establish new indigent care funding mechanisms, it should consider the utility and effectiveness of existing ones. This is particularly true in light of changes in hospital reimbursement mechanisms, which crease incentives for hospitals which may run counter to their charitable obligations. It may be that in a competitive, price-derived hospital market the tax exemption no longer makes sense, or that it is no longer reasonable to assume that any hospital which adopts the nonprofit form provides sufficient charitable service to be presumptively entitled to exemption.

---

[10] See generally Buttler, New Initiatives in Financing and Delivery of Health Care For the Medically Indigent LAW, MEDICINE, AND HEALTH CARE 225 (October, 1985).

[11] Source: California Office of Statewide Health Planning and Development, Aggregate Hospital Financial Data for California (report periods ending June 30, 1984-June 29, 1985).

In addition, closer monitoring of nonprofit community hospitals' charitable performance is desirable to assure equity between nonprofit and investor-owned hospitals. It is inequitable to provide a $300 million subsidy to one class of hospitals in a state and not another if the difference between the two does not warrant it.

Finally, closer examination of nonprofit hospitals' charitable performance is desirable to ascertain whether the burden of charity care is equitably distributed among such hospitals.

Interest in the connection between indigent care and the community hospital tax exemption has substantially increased recently. A major precipitating factor has been the decision of the Utah Supreme Court in Utah County v. Intermountain Health Care 709 P.2d 265 (Utah 1985). In that case, the court ruled that two hospitals owned and operated by Intermountain Health Care, a nonprofit hospital chain corporation, were not exempt from property taxes under the state constitution's charitable exemption provision. State taxing authorities had ruled the hospitals exempt under a state statute which granted exemption to nonprofit institutions that provided "hospital" services and satisfied certain limitations on private benefit. The court found the statute inconsistent with the state constitutional provision since it presumptively exempted nonprofit hospitals without a actual showing of charitable performance or "gift to the community". The Court held that the Intermountain hospitals (which derived most of their revenues from patient charges, provided charity care with a value less than one percent of their gross revenues, and operated in essentially the same manner as investor-owned hospitals) had failed to provide evidence of such a "gift to the community". The essence of the court's decision in Intermountain was that given the sweeping changes in the hospital industry in recent years, a hospital cannot automatically claim tax exemption merely because it is nonprofit and organized for hospital purposes. Instead it must make a factual showing of nonreciprocal provision of charitable services or alleviation of a government burden.

It is important to recognize that the Intermountain decision does not represent the law of California. If it did, a substantial number of presently exempt California nonprofit community hospitals would probably forfeit their property tax exemption. However, as Section II of this report indicates, present California law appears to incorporate the presumption of exemption rejected by the Utah Supreme Court.

We are not the first to suggest that in the context of the debate over indigent care the question of charitable service by nonprofit community hospitals deserves closer scrutiny. The authors of a recent Institute of Medicine study on the increasing presence of investor-owned organizations in the hospital sector have said:

> Public policy cannot rely indefinitely on the ability and willingness of health care institutions to generate the funds needed to provide care for those who are unable to pay. Hospitals have very limited income from sources other than patient-care revenues, and payors are becoming less willing to pay rates that allow hospitals to subsidize care of patients who do not pay. The solution to the problem of access will ultimately require new revenues from government at the federal, state, or local level. In the meantime, greater attention should be paid to ensuring continuation of the historical missions of institutions that change ownership, to the use of taxes paid by taxpaying health care organizations to improve access, and to the requirements for tax-exempt status.[12]

Comparison of the Revenue Loss from the Hospital Tax Exemption with Hospital Charitable Service

As indicated above, for 1984-85 the tax loss from the California nonprofit community hospital exemption from income and property tax on operations was $300 million. During this period, California nonprofit community hospitals reported the provision of $82 million in charity care.[13] The value of charity care provided was thus the equivalent of only 27 percent of the tax loss caused by the nonprofit tax exemption.[14]

The actual proportion of charity care to lost tax revenues may be substantially less. First, if the tax loss caused by the nonprofit community hospital income tax exemption were calculated on non-operating revenue as well as operating revenue, the total federal/state income and property tax revenue loss would be $440 million. Second, the value of charity care reported under the California health facility data collection system is apparently measured by the hospitals' stated charges for services. In practice, most hospital payors (e.g. Medicare, Medicaid, health insurers) negotiate discounts from hospital stated charges.

---

[12] Gray & McNerney, For-profit Enterprise in Health Care: The Institute of Medicine Study 314 NEW ENG.J.MED. 1523 (1986).

[13] Source: California Office of Statewide Health Planning and Development, Aggregate Hospital Financial Data for California (report periods ending June 30, 1984-June 29, 1985).

[14] By using charity care cost data reported by nonprofit community hospitals to the California Health Facilities Commission as the measure of charity care provided, this report accepts the hospitals' own definition of charity care, and excludes certain deductions from revenue which are sometimes classified with charity care as "uncompensated care costs." These deductions

---

[14] are "contractual adjustments" (discounts from hospital's stated charges negotiated by many payors, most notably Medicare and Medicaid) and "bad debt" (uncollectible accounts receivable). Such costs are not appropriately counted in measuring the level of public service provided by nonprofit community hospitals. Hospitals freely negotiate contractual adjustments or discounts with payors, and they cannot be said to provide something of value to the public when they arrive at a particular price in open negotiations. Cf. St. Francis Hospital Center v. Heckler 714 F.2d 872, 875 (7th Cir. 1983) cert. den. 465 U.S. 1022 (1984) (hospital participation in Medicare program is voluntary). Additionally, for-profit hospitals are not permitted to treat contractual adjustments either as expenses or charitable contributions. If the granting of contractual adjustments does not constitute the transfer or loss of tangible, valuable property for proprietary hospitals, neither should it for nonprofits.

Bad debts are costs of doing business, whether in the nonprofit or for-profit mode. There is no reason to presume that bad debt in a nonprofit community hospital represents anything other than a business decision that the cost of attempting to collect on a debt is greater than the potential gain. California nonprofit community hospitals actually spend a greater percentage of their revenues on collections than proprietary hospitals, a fact inconsistent with the suggestion that nonprofit bad debt represents anything other than a business loss. However, nonprofit community hospitals may not have the incentive to carefully differentiate between charity care and bad debt in reporting to data collection sources, and some of what they report as bad debt may in fact constitute charity care. A method of estimating the amount of nonprofit community hospital bad debt that in fact constitutes charity care is to assume that the bad debt ratio of proprietary hospitals reflects the industry wide actual bad debt experience, and to treat the portion of reported nonprofit community hospital bad debt in excess of the proprietary bad debt ratio as charity care. Applying this method increases the estimated annual amount of charity care provided by California nonprofit community hospitals by $19 million to $100 million.

The average discount rate for California nonprofit community hospitals for 1984-85 was 19 percent. If we assume that were charity care purchased on the open market a similar discount could be obtained, the market value of the care provided would actually be the stated charge less 19 percent. Thirdly, nonprofit community hospitals received $16 million in gifts and subsidies for indigent care offsetting their costs of charity care in 1984-85. Finally, a portion of the charity care reported to the California health facility data collection system represents services rendered to indigent persons in fulfillment of hospitals' Hill-Burton obligations. Such services are provided in return for the earlier receipt of Hill-Burton funds by the hospital, and as such are an obligation independent of the hospital's charitable responsibilities. See *Cook v. Rose* 299 S.E.2d at 5 (W.Va. 1982); *Cf*. *Johnson County Memorial Hospital v. Schweiker* 698 F.2d 1350 (7th Cir. 1983) (Hill-Burton charity care is *quid pro quo* for Hill-Burton funding).

The discrepancy between aggregate levels of charity care and tax benefits does not, of course, prove that any individual hospital is not entitled to property or income tax exemption. First, there are undoubtedly many individual nonprofit community hospitals, particularly in inner-city areas, whose level of charity care substantially exceeds their tax benefits. Such facilities are likely to have both high indigent care levels and low net revenues. Both the "level playing field" concept and the policy underlying the nonprofit community hospital tax exemption would suggest such facilities deserve additional subsidization, not a reduction in their tax subsidy. As noted above, several states have considered or recently adopted legislation designed to redistribute revenues from other facilities to such hospitals. Second, several elements of public service in addition to uncompensated charity care may be provided by nonprofit community hospitals. Often listed among those are educational and research activities, the provision of unprofitable services and the exercise of restraint in pricing. The value of such activities is difficult to quantify, particularly in the aggregate. Nonprofit community hospitals do not, by and large, seek tax exemption as educational or scientific research organizations, and educational and research costs may be borne by third-party payors or granting agencies.[15] With respect to unprofitable services, given the well-documented excess hospital capacity in the U.S. we are sceptical of any argument that maintaining services for which there is insufficient demand constitutes a public service. We are also sceptical of the general proposition that pricing or output practices (such as "restraint in pricing") which are not necessarily inconsistent with competitive behavior can be deemed public service. However, we can envision a hospital with a natural or legal monopoly successfully making a pricing restraint or unprofitable service argument. Individual nonprofit community hospitals should be entitled to offer tangible evidence of these and other forms of public service in their income or property tax exemption applications, but no general presumption that nonprofit hospitals provide these or other forms of public service should exist.

---

[15] *E.g.*, 42 U.S.C.A. §1395ww(d)(5)(B), (h)(1987 Cum.Ann. Pocket Part) (Medicare payment for medical education costs).

The discrepancy between aggregate levels of charity care and tax benefits to nonprofit community hospital in California may not be replicated in other states. The competitiveness of the California hospital market and the relative generosity of the California Medicaid program may diminish both the willingness of California nonprofit community hospitals to provide charity care and the demand for charity care to levels below those of other states.

Notwithstanding the foregoing, the discrepancy between aggregate levels of charity care and tax benefits suggests the appropriateness of some consideration of the level of uncompensated charity care provided whenever a determination is made whether or not an individual nonprofit community hospital is entitled to an exemption. However, as Section II of this Report indicates, California law as currently interpreted by the courts apparently does not provide for consideration of the level of charity care provided (either in absolute terms, relative to other institutions, or relative to its tax benefit) by the nonprofit community hospital seeking exemption.

II. Challenging a Nonprofit Community Hospital's Tax Exemption

You have asked how a nonprofit community hospital's property tax exemption might be challenged on the grounds of inadequate provision of charity care or other public service benefit, and how such a challenge might fare in the courts.

To the best of our knowledge, all nonprofit community hospitals in California annually apply for and are granted in due course a "welfare" exemption from local property taxation on the grounds that their property is used exclusively for hospital and charitable purposes. In addition, all are exempt from federal and state income tax as charitable institutions.

The regularity with which exemption from property tax is granted does not mean that disputes over the exemption have never arisen. In fact, there has been a significant amount of litigation in California, often brought by local tax assessors over the entitlement of hospital-owned property to exemption. However, the great majority of these disputes concern issues other than the question of the public service obligations of exempt hospitals, and concern such questions as the exemption of hospital-owned medical buildings, etc. Thus, a challenge to a nonprofit community hospitals property tax exemption on the grounds of insufficient dedication to public service and charity care would be an unusual and essentially unprecedented event.

The procedure for bringing such a challenge by a county tax assessor would not be particularly complicated. Under California law county assessors initially review and consider counsel claims for property tax exemption. The county Assessor makes a recommendation to grant or deny the claim to the State Board of Equalization. The Board is authorized to hold hearings on the eligibility of an applicant. The Board then reviews the claim and makes a finding on the eligibility of an applicant. The County Assessor may deny the claim of an applicant the Board finds eligible, but it may not grant the claim of an applicant the Board finds eligible.[16]

The most direct way to challenge a nonprofit community hospital's property tax exemption would be for a county assessor to recommend denial of the hospital's annual exemption claim. It is quite likely that a recommendation to deny a nonprofit hospital exemption would be deemed sufficiently unusual to prompt the Board of Equalization to hold hearings. If the Board found the hospital eligible despite the county's recommendation, the assessor could still deny the exemption and make the assessment. The hospital would have to pay the tax, be denied a claim for refund, and then bring suit to recover the taxes.

An alternative method for challenging the exemption is available. A county assessor is permitted to sue the State Board of Equalization for declaratory relief. Section 538 of the Revenue and Taxation Code requires an assessor to bring such an action in lieu of making an assessment if he believes a specific California constitutional, statutory, or regulatory provision is unconstitutional or invalid, or if the assessor proposes to adopt an interpretation of such a provision which would result in the denial of exemption to 5 or more assessees. The statute allows intervention in the suit by potential assessees as well as other assessors.

Each of these alternative ways of getting to court has certain advantages and disadvantages. The declaratory relief route allows immediate access to court, while the assessment denial route requires preliminary administrative proceedings. In general, the declaratory relief route appears to be designed for situations in which the county assessor seeks a general modification or reinterpretation of the law applicable to all nonprofit community hospital assessees, while the assessment denial route appears more appropriate if the underlying issues relate to the sufficiency of the facts presented in an individual hospital's claim to show entitlement under existing law. Since the prospects for successful challenge of the tax exemption of even a hospital with a poor charitable service record would be virtually nonexistent unless the court could be persuaded to modify or reinterpret current California law, the declaratory judgment route would appear to be the preferred choice.[17]

---

[16] See generally, CA. Rev. and Tax. Code Sec. 254.5.

What are the prospects that a county assessor could win such a lawsuit? We think there would be no chance of success unless the court could be persuaded to fundamentally rewrite California law in this area, and to follow a line of reasoning similar to that evinced by the Utah Supreme Court in the Intermountain decision described above. As a practical matter, such a case would be won, if at all, in the California Supreme Court, since a victory would effectively require overruling several decisions of that court, which lower courts are not likely to be willing to do, and (given the importance of the issue at dispute) a lower court victory would almost assuredly be appealed by the hospital or hospital industry representatives.

The reason why success in such a lawsuit would be so difficult to win is that the California constitutional and statutory provisions establishing the nonprofit community hospital property tax exemption do not expressly indicate whether any public benefit in the form of charity care is required in order to claim the exemption. As indicated above, the applicable constitutional and statutory provisions, Article XIII, Sec. 4(b) and Rev. and Tax. Code Sec. 214, expressly require only that exempt nonprofit community hospital property be exclusively used for one of the following purposes: "religious, hospital, scientific, or charitable". Nonprofit community hospitals can therefore come within the exemption provision without a dedication of their property to a charitable use. In addition, the leading California Supreme Court decision considering the nonprofit community hospital tax exemption, Cedars of Lebanon Hospital v. Los Angeles County, 35 C.2d 729, 221 P.2d 31 (1950) contains language which seems to imply that the simple fact of providing modern hospital services is sufficient to qualify as an exempt "hospital purpose".

Cedars of Lebanon was brought by several hospitals, not long after the welfare exemption statute was passed, to recover taxes paid under protest. While the definition of hospital purpose was not an expressly litigated issue in the case, the Court did offer the following "fair and unchallenged definition" of the "nature, functions, and purposes of a complete, modern hospital plant":

> "A hospital is primarily a service organization. It serves three groups: the patients, its doctors, and

---

[17] There is another reason for selecting the declaratory judgement proceeding option. Sec. 5152 of the Revenue and Taxation Code, enacted simultaneously with Sec. 538, provides that if a taxpayer files a claim in which a court determines that an assessor should have followed the proceedures outlined in Sec. 538 instead of assessing taxes against the claimant's property , the taxpayer will be entitled to attorney's fees and costs as a part of the judgment.

> the public. It furnishes a place where patient, whether poor or rich, can be treated under ideal conditions. It makes available room, special diet, X-ray, laboratory, surgery, and a multitude of other services and equipment now available through the advances of medical science. Essential to the administration of these techniques is the core of highly-trained nurses and student nurses who are on duty twenty-four hours per day. In the large hospitals there are the interns and residents whose presence make it possible for the hospital to do a better job. In addition, the hospital must have administration to see that its services function properly and are coordinated, and that patients are received and cared for regardless of the hour or the patient's condition. Nothing can be left to chance because a slip may mean a life or many lives. These facilities stand ready to serve the community in times of epidemic or disaster." (35 Cal.2d at 735, 221 P.2d at 35)

A contemporary court asked to decide whether a measurable level of charity is incorporated into hospital purposes would probably begin by looking to the definition in Cedars of Lebanon for primary guidance. The Cedars of Lebanon definition does incorporate some elements of charity: the idea of service to the public, a place where both rich and poor can be treated, and service to the community in times of epidemic and disaster. However, these charitable elements are highly indefinite, and suggest charity only in the sense of general community benefit. They do not expressly reflect the concept of charity that relieves government of a burden it would otherwise have to bear, or augments and enhances government services. It would be difficult to prove that charity care *quid pro quo* was incorporated into this language and into the definition of "hospital purposes."

This is not to say that charity care has never been considered in determining the entitlement of a California hospital to property tax exemption. For example, in St. Francis Hospital v. City and County of San Francisco 137 C.A.2d 321, 325-6 (1955) the Court held that a hospital was organized and operated for hospital and charitable purposes and not for profit on the basis of evidence that charges for patient's rooms were less than payroll expense per patient day, rates were not fixed with the purpose of creating profit, the hospital had 252 charity or part pay patients during the year, and certain of its clinics were established for patients unable to pay the full cost of private hospital care. Furthermore, we know of no California case in which arguments about the charity care performance of a hospital relative to its tax benefits or to the charity care performance of other hospitals have been presented to and explicitly rejected by a court. However, this is another way of saying that to make such an argument now is to ask the court to make new law, or at least to interpret existing law in a significantly different way from previous interpretations.

To do so with any degree of possibility of success, it would be necessary to present the court with an egregious or extreme case. The hospital assessed would preferably be one with the following kinds of characteristics:

- High property valuation
- No operating deficit; preferably operating revenues exceeding expenses by a figure close to ten percent.[18]
- Below average levels of charity care as a percentage of gross revenue, and in comparison with other comparable hospitals, and in comparison with the tax benefits from all tax exemptions (i.e., both federal/state income and local property tax exemptions)
- No unique characteristics which might qualify the hospital for special consideration.
- Management and operation not significantly different from a proprietary hospital.
- A "bad actor" nonprofit, e.g. one which has been acquiring others, or owns for-profit subsidiary enterprises, or which has been turning away indigent patients, or otherwise acting in an apparently non-public spirited manner.

There are several substantive legal argument that might be made to show why such a hospital should not be entitled to exemption.

First, it could be argued that the original intent of the property tax exemption for "hospital purposes" in the California constitution incorporate a requirement of charitable service which the hospital, by reason of its low level of charity care, did not satisfy.

To avoid the response that such a requirement is not apparent in Cedars of Lebanon and similar cases, it would probably be best to argue, admittedly somewhat disingenuously, that Cedars of Lebanon and the other cases construe the phrase "hospital purposes" as it appears in Rev. and Tax. Code Sec. 214, not as it appears in Article XIII, Sec. 4(b) of the Constitution, and that to the extent Sec. 214 is not interpreted to include a charitable service requirement, it is inconsistent with Article XIII, Sec. 4(b).

---

[18] Rev. & Tax Code Sec. 214(a)(1) establishes a conclusive presumption that hospitals whose operating revenues do not exceed expenses by more than ten percent are not organized or operated for profit.

The argument would then be that Article XIII Sec. 4(b) was originally intended to grant exemption to organizations providing relief of governmental obligations. The provision was enacted by voter initiative in 1944, at a time when there was a tax revenue surplus. It was sponsored by a council of social agencies in Los Angeles. Public officials were part of this coalition and active throughout the campaign. According to the sponsors of the legislation, its intention was to relieve charitable organizations of their tax obligations under the rationale that the services provided by these organizations, if performed by governmental agencies, would cost the taxpayers more than the loss of revenue resulting from exemption. The argument to the voters in 1944, under the caption "Fair Play for Charities," said:

> These nonprofit organizations ["welfare agencies serving youth, old age, the sick and handicapped"] assist the people by proving important health, citizenship and welfare contributions either directly or through a Community Chest. It is good public policy to encourage such private agencies by exemption rather than to continue to penalize and discourage them by heavy taxation.
>
> The ability of these agencies to serve you is reduced when a share of your contribution given to aid their work is absorbed by the property tax. The tax has also discouraged and in many cases prevented charitable agencies from securing greatly needed additional facilities to meet growing population needs . . .
>
> Exemption of these charities from taxation would mean a loss to counties of only 2/10 of 1 percent. To the taxpayer this would mean a possible 1 cent increase per hundred dollars of assessed valuation. Additional health and welfare services resulting from the exemption, in fact, would save taxpayers the entire exemption cost. (Emphasis added)[19]

Although the term "charity" even then was interpreted broadly as a community benefit (not just a benefit to the poor), it was not without some measurable standard. The argument made was that charities relieve government of a burden it might otherwise have to undertake. It was argued that the exemption would "pay for itself" in the increase in services provided to the whole community by charitable agencies, services for which the individual taxpayer had already paid in whole or part through direct contribution to these organizations.[20]

---

[19] As quoted in 35 S.C.L.R. 276 at 282, note 33. The legislative history of the welfare exemption was recounted in "Fifield Manor Tax Refund Cases: True Meaning of "Charity" Under California Welfare Tax Exemption Restated," (1962) 35 S.C.L.R. 276.

Second, the argument could be made that Rev. and Tax. Code Section 214.8 (which requires an organization seeking property tax exemption to be eligible for state or federal income tax exemption) has the effect of imposing on property tax-exempt organizations the requirements of charitable service contained in the applicable income tax provisions. The applicable tax provisions are Rev. and Tax. Code Sec. 23701(d) and Int. Rev. Code Sec. 510(c)(3). A nonprofit community hospital claiming exemption under these provisions would have to show that it was organized for "charitable" purposes, since neither the federal nor the state statute provides an exemption for entities organized for "hospital purposes".

Although this theory has the advantage of allowing the plaintiff to allege that a hospital's duty of public service is measured by its dedication to the possibly stricter standard of "charitable" use, not merely "hospital" use, we think it would be difficult to win. First, the courts are likely to defer to the judgement of the I.R.S. and its California equivalent, the Franchise Tax Board, on the interpretation of charitable purposes and the hospital's conformity thereto. Second, with respect to "charitable" purposes under the state income tax exemption statute, there have been no court decisions interpreting the phrase. Therefore, we think a court asked to determine whether a hospital met the charitable purpose test of Sec. 23701d would look to case law on the same subject under Sec. 214. The analogy would be natural since many of the requirements for charitable income tax exemption are the same as those for charitable property tax exemption. Unfortunately, the decisions interpreting charitable purpose under Sec. 214 have endorsed definitions of charity as community benefit at its most generalized level. For instance, in *Stockton Civic Theatre v. Board of Supervisors* (1967) 66 Cal.2d 12, 43 P.2d 810 the California Supreme Court held that an amateur theatre group's activities were educational and charitable because "when given to the community, [the activities] are humanitarian in nature and contribute to the improvement and benefit of mankind." The theater group's property therefore qualified for property tax exemption. The court ignored a lower court warning that such a test of charity would allow property tax exemption of virtually any nonprofit organization.[21]

---

[20] Recognition of this rationale exists in Cedars of Lebanon in the concurring and dissenting opinion of Justice Shenk. He wrote

> It is obvious that the welfare exemption is designed to serve both social and economic ends. The electors of the state must be deemed to have been aware of the need of the services afforded by the designated organizations when carried on impartially and without self-interest. Implicit in the legislation is the knowledge that the maintenance of the facilities and the dispensation of the services as a result of private contributions of funds and personal effort become less of a burden on the taxpaying public than would be the cost under public ownership and control. The lessened cost of operation by the relief from taxation of such organizations also renders the services more widely available to those for whom they are intended. The resulting cost reduction must have been considered a greater benefit to the people than decreased taxes if the properties were not exempt. 35 C.2d at 350-51.

The test for charity under the federal statute is likewise very general, although its history is different. Before 1969 the IRS interpreted 501(c)(3) to require a hospital to operate to the extent of its financial ability for those not able to pay for services rendered, and not exclusively for those who were able and expected to pay.[22] In 1969, responding in part to criticism that this standard did not account for the increased reimbursement sources available to indigents from Medicare and Medicaid (and therefore the supposed anachronism of treating hospitals as "almshouses"), the IRS issued Rev. Ruling 69-545. This ruling appeared to state a different test for charitableness. A hospital was said to have a charitable nature if: (1) its board of directors was drawn from the community and its medical staff was open; (2) it operated a full time emergency room open to all, regardless of ability to pay; and (3) it served persons able to pay for their care directly or through third party reimbursement. The IRS standard had thus moved away from a notion of charity as relief of poverty to charity as generalized community benefit. Later IRS rulings have confirmed that the promotion of health is sufficient to meet the charitable purpose test for tax exemption.[23]

---

[21] *See also Greek Theatre Assoc. v. Los Angeles County* (1978) 76 Cal.3d 768, 142 Cal.Rptr. 919 (nonprofit theatrical/musical organization of professional performers exempt); *Santa Catalinna Island Conservancy v. County of Los Angeles* (1981) 126 Cal. App.3d 221, 178 Cal.Rtpr. 708 (organization dedicated to preserving open space for recreational purposes exempt); and *J. Paul Getty Museum v. County of Los Angeles* (1983) 148 Cal. App.3d 600, 195 Cal.Rptr. 916 (museum property may be exempt under charitable purpose).

[22] The level of charitable service provided was one factor in determining exemption, but not conclusive. *See, e.g.* Rev. Ruling 56-185: "The fact that its charity record is relatively low is not conclusive that a hospital is not operated for charitable purposes to the fullest extent of its financial ability. It may be offer services at reduced rates which are below cost and thereby render charity in that manner. It may also set aside earnings which it uses for improvements and additions to hospital facilities. It must not, however, refuse to accept patients in need of hospital care who cannot pay for such services. Furthermore, if it operates with the expectation of full payment from all . . . it does not dispense charity merely because some of its patients fail to pay for the services rendered." 1956-1 Cum.Bull. 202.

Although other variations on the legal theories discussed above could be advanced, it is unlikely that they would provide any greater probability of success. In short, the greatest value of litigation challenging the nonprofit hospital tax exemption would be to publicize concern over the issue of charity care, or to support an effort to secure legislation changing the statutory test for exemption.

III. SUGGESTIONS FOR FURTHER STUDY

You have asked for our recommendations for further study, and legislative options to more closely tie property tax exemption in California to levels of charity care or other public service.

We recommend that further study be undertaken of the value of uncompensated charity care provided by California nonprofit community hospitals in relation to the tax revenues foregone as a consequence of their tax exemption. All of the estimates of the amounts in this report were based on aggregate data available to the public in hard copy by the California Office of Statewide Health Planning and Development. More detailed information is available on computer tape with respect to individual facilities. For example, it should be possible with a special computer run to exclude Hill-Burton care from the calculation of aggregate charity care provided by California nonprofit hospitals, since individual hospitals reports apparently distinguish such care.

Second, we recommend that consideration be given to amendment or supplementation of Ca. Rev. and Tax. Code §214 in such a way as to place the burden of proving entitlement to property tax exemption more clearly on a hospital claimant, and to provide that entitlement to a hospital exemption would require an affirmative showing of uncompensated charity care or other form of service to the community beyond the mere furnishing of modern hospital services to the general public.

One method to accomplish this purpose would be to add to Section 214 a provision stating that:

> "Hospital purposes" as used in this section, must include the provision of a reasonable volume of uncompensated charity care to persons unable to pay therefor, either in whole or in part.

---

[23] See, e.g. Rev. Ruling 83-157.

The effect of such a provision would be to require nonprofit community hospitals seeking exemption under this provision to come forward with evidence of the provision of a reasonable volume of uncompensated charity care. Specification of a "reasonable volume" would be the task of the Board of Equalization, whose determination would take into account relative levels of charity care provided by various classes of hospitals in the state and the value of care provided in relation to the tax benefit received from exemption.

Another alternative would be to provide that:

> Property owned and operated by a community chest, fund, foundation, or corporation for the operation of a general acute care hospital as defined in Section 1250 of the Health and Safety Code shall be deemed property used exclusively for hospital purposes if the value of charity care services as a percentage of gross revenues reported by such facility pursuant to Part 1.8 of Chapter 5 of Part 1, Division 1 of the Health and Safety Code is greater than the value of charity care as a percentage of gross revenues reported by all general acute care hospitals in California for the most recent report period.

The effect of this alternative would be to establish a conclusive presumption that a hospital with above-average charity care was engaged in "hospital purposes". A hospital with below-average charity care performance would not be entitled to the presumption, and would have to make a factual showing of entitlement.

Still another alternative would be to eliminate the exemption but provide that tax revenues collected from hospitals would be earmarked for a special fund, from which hospitals providing charity care could obtain reimbursement.

Detailed consideration of options such as these will require further study, both of legal and public policy considerations. However, we believe that the time is ripe for such consideration as a matter of sound tax and fiscal policy, equitable and rational health policy in the current era of health services deregulation, and welfare policy with respect to the problem of medical indigency.

since the property exempted by this act has never in fact been taxed."

1975 Amendment. Substituted. "Personal" for "As used in Section 214, 'property used exclusively for religious, hospital, scientific or charitable purposes' shall include the" at the beginning of subd. (a), inserted "shall be exempt from taxation" preceding the proviso in subd. (a), and added subd. (b).

Sections 2 to 4 of Stats.1975, c. 808, p. 1840, provide:

"Sec. 2. Section 1 of this act is a clarification of existing law as enacted by Chapter 31 of the Statutes of 1974 in order to implement the intent of the Legislature to exempt from taxation personal property owned by the Civil Air Patrol beginning with the 1975–76 fiscal year.

"Sec. 3. This act does not require state reimbursement of local governments under Section 2229 of the Revenue and Taxation Code because there is no actual loss of revenue since the property exempted by this act has never in fact been taxed.

"Sec. 4. Any tax or penalty or interest thereon for any fiscal year commencing during the 1975 calendar year on personal property owned by any organization which would have qualified for the exemption provided in Section 213.6 of the Revenue and Taxation Code as amended by this act, had that section been in existence on the lien date in 1975, shall be canceled pursuant to Article 1 (commencing with Section 4986) of Chapter 4 of Part 9 of Division 1 of the Revenue and Taxation Code as if it had been levied or charged erroneously; and if paid, a refund thereof shall be made pursuant to Article 1 (commencing with Section 5096) of Chapter 5 of Part 9 of Division 1 of the Revenue and Taxation Code as if it had been erroneously collected. Any cancellation or refund made pursuant to this section shall be made provided an appropriate application for exemption is filed within 60 days of the effective date of this act."

1979 Amendment. Extended effectiveness of the section to the lien date in "1985" instead of "1980".

Library References

Taxation ⇐241.1(1), (2).
C.J.S. Taxation § 282 et seq.

§ 214. Exemptions: property for religious, hospital, scientific or charitable purposes; property owned and operated by religious, hospital or charitable funds, foundations or corporations; requirements; particular property

(a) Property used exclusively for religious, hospital, scientific, or charitable purposes owned and operated by community chests, funds, foundations or corporations organized and operated for religious, hospital, scientific, or charitable purposes is exempt from taxation if:

(1) The owner is not organized or operated for profit; provided, that in the case of hospitals, such organization shall not be deemed to be organized or operated for profit, if during the immediate preceding fiscal year the excess of operating revenues, exclusive of gifts, endowments and grants-in-aid, over operating expenses shall not have exceeded a sum equivalent to 10 percent of such operating expenses. As used herein, operating expenses shall include depreciation based on cost of replacement and amortization of, and interest on, indebtedness * * *;

(2) No part of the net earnings of the owner inures to the benefit of any private shareholder or individual * * *;

(3) The property is used for the actual operation of the exempt activity, and does not exceed an amount of property reasonably necessary to the accomplishment of the exempt purpose * * *;

(4) The property is not used or operated by the owner or by any other person so as to benefit any officer, trustee, director, shareholder, member, employee, contributor, or bondholder of the owner or operator, or any other person, through the distribution of profits, payment of excessive charges or compensations or the more advantageous pursuit of their business or profession * * *;

(5) The property is not used by the owner or members thereof for fraternal or lodge purposes, or for social club purposes except where such use is clearly incidental to a primary religious, hospital, scientific, or charitable purpose * * *;

(6) The property is irrevocably dedicated to religious, charitable, scientific, or hospital purposes and upon the liquidation, dissolution or abandonment of the owner will not inure to the benefit of any private person except a fund, foundation or corporation organized and operated for religious, hospital, scientific, or charitable purposes * * *;

(7) The property, if used exclusively for scientific purposes, is used by a foundation or institution which, in addition to complying with the foregoing requirements for the exemption of charitable organization in general, has been chartered by the Congress of the United States (except that this requirement shall not apply when the scientific purposes are medical research), and whose objects are the encouragement or conduct of scientific investigation, research and discovery for the benefit of the community at large.

The exemption provided for herein shall be known as the "welfare exemption." This exemption shall be in addition to any other exemption now provided by law and the existence of the exemption provision in paragraph (2) of subdivision (a) of Section 202 shall not preclude the exemption under this section for museum or library property. Except as provided in subdivision (e), this section shall not be construed to enlarge the college exemption.

(b) Property used exclusively for school purposes of less than collegiate grade and owned and operated by religious, hospital or charitable funds, foundations or corporations, which property and funds, foundations or corporations meet all of the requirements of subdivision (a), shall be deemed to be within the exemption provided for in subdivision (b) of Section 4 and Section 5 of Article XIII of the Constitution of the State of California and this section.

(c) Property used exclusively for nursery school purposes and owned and operated by religious, hospital or charitable funds, foundations or corporations, which property and funds, foundations or corporations meet all the requirements of subdivision (a), shall be deemed to be within the exemption provided for in subdivision (b) of Section 4 and Section 5 of Article XIII of the Constitution of the State of California and this section.

(d) Property used exclusively for a noncommercial-educational FM broadcast station or an educational television station and owned and operated by religious, hospital, scientific or charitable funds, foundations or corporations meeting all of the requirements of subdivision (a), shall be deemed to be within the exemption provided for in subdivision (b) of Section 4 and Section 5 of Article XIII of the Constitution of the State of California and this section.

(e) Property used exclusively for religious, charitable, scientific, or hospital purposes and owned and operated by religious, hospital, scientific, or charitable funds, foundations, or corporations or educational institutions of collegiate grade, as defined in Section 203, which property and funds, foundations, corporations, or educational institutions meet all of the requirements of subdivision (a), shall be deemed to be within the exemption provided for in subdivision (b) of Section 4 and Section 5 of Article XIII of the Constitution of the State of California and this section.

(f) Property used exclusively for housing and related facilities for * * * elderly or handicapped families and financed by, including, but not limited to, the federal government pursuant to Section 202 of Public Law 86-372 (12 U.S.C. Sec. 1701q), as amended,[1] Section 231 of Public Law 73-479 (12 U.S.C. Sec. 1715v)[2], or Section 236 of Public Law 90-448 (12 U.S.C. Sec. 1715z)[3], and owned and operated by religious, hospital, scientific or charitable funds, foundations or corporations meeting all of the requirements of this section shall be deemed to be within the exemption provided for in subdivision (b) of Section 4 and Section 5 of Article XIII of the Constitution of the State of California and this section. The amendment of this paragraph made at the 1983-84 Regular Session of the Legislature does not constitute a change in, but is declaratory of, the existing law. However, no refund of property taxes shall be required as a result of this amendment for any fiscal year prior to the fiscal year in which the amendment takes effect.

Property used exclusively for housing and related facilities for elderly or handicapped families at which supplemental care or services designed to meet the special needs of elderly or handicapped residents are not provided, or which is not financed by the federal government pursuant to Section 202 of Public Law 86-372 (12 U.S.C. Sec. 1701q), as amended, Section 231 of Public Law 73-479 (12 U.S.C. Sec. 1715v), or Section 236 of Public Law 90-448 (12 U.S.C. Sec. 1715)[4], shall not be entitled to exemption pursuant to this subdivision unless the property is used for housing and related facilities for low- and moderate-income elderly or handicapped families. Property which would otherwise be exempt pursuant to this subdivision, except that it includes some housing and related facilities for other than low- or moderate-income elderly or handicapped families, shall be entitled to a partial exemption. The partial exemption shall be equal to that percentage of the value of the property which is equal to the percentage which the number of low- and moderate-income elderly and handicapped families occupying the property is of the total number of families occupying the property.

As used in this subdivision, "low and moderate income" has the same meaning as the term "persons and families of low or moderate income" as defined by Section 50093 of the Health and Safety Code.

(Amended by Stats.1974, c. 311, p. 594, § 21; Stats.1978, c. 1112, p. 3389, § 6; Stats.1979, c. 1188, p. 4641, § 1.5, urgency, eff. Sept. 30, 1979; Stats.1984, c. 1102, p. ——, § 1; Stats.1985, c. 542, p. ——, § 2, imd. eff. Sept. 9, 1985.)

[1] 12 U.S.C.A. § 1701q.

[2] 12 U.S.C.A. § 1715v.

[3] Probably should read "Sec. 1715z-1". See 12 U.S.C.A. § 1715z-1.

[4] Probably should read "1715z-1". See 12 U.S.C.A. § 1715z-1.

Addition of subd. (e) operative for 1986-87 fiscal year, see note, post.

Chairman PICKLE. Thank you, Mr. Stark. You made reference to a study that had been made by a group in California. I have before me a letter addressed to you from the Western Consortium for Health Professions, signed by Mr. James Simpson. Is this the report?

Mr. STARK. That is the cover letter. I don't know if it is the complete report, if not I will see that the Chair has it.

Chairman PICKLE. I just want to be sure that is the one you referred to.

Mr. STARK. Yes, that is.

Chairman PICKLE. When you say that your opinion is, one answer is why not cancel all tax-exempt organizations and let them deduct their actual expenses.

Mr. STARK. And perhaps create a special category for medical charitable care to give them that.

Chairman PICKLE. Is that a position of the nonprofit hospitals. Do they support that approach?

Mr. STARK. I would doubt it, Mr. Chairman. I have yet to see any hospital group support anything that really helps the community more than it helps their balance sheet. So that that would be a wondrous and new position for the hospital community but——

Chairman PICKLE. Now that you have raised the question though, we might expect some comment from them during the morning.

Mr. STARK. I would hope so, and I hope it enlightens the panel.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Mr. Chairman, I have no questions other than to thank our colleague for his usual stimulating presentation.

Chairman PICKLE. Mr. Flippo.

Mr. FLIPPO. I, too, wish to thank our colleague for his testimony. Thank you.

Mr. STARK. I thank the gentleman.

Chairman PICKLE. Our first panel this morning consists of Ms. Robin Holm, Paul Simmons, Former Secretary and good friend, Harry Groome, and Steven Fellman.

If you will come forward and take your place at the witness table. For identification purposes, Robin Holm is representing the National Hearing Aid Society; Mr. Groome represents the American Clinical Laboratory Association; Mr. Simmons represents the Health Industry Distributors Association, Mr. Secretary, nice to see you; and Steven Fellman, general counsel for the Textile Rental Services Association of America.

We will be first pleased to hear from Ms. Holm.

STATEMENT OF ROBIN HOLM, PRESIDENT-ELECT, NATIONAL HEARING AID SOCIETY

Ms. HOLM. Thank you, Mr. Chairman.

Chairman PICKLE. I remind you in the interest of time we are asking the witnesses to condense their testimony to four minutes. All of the statements will be included in the record.

Ms. HOLM. Fine, thank you, Mr. Chairman, members of the committee.

My name is Robin Holm and I am the president-elect of the National Hearing Aid Society, the professional association of some 4,000 hearing aid specialists nationwide. I speak to you today on their behalf. I have submitted written testimony to the committee which outlines the crisis facing my profession which results from the burgeoning commercial activity of tax-exempt hearing aid sales facilities.

My husband John and I own the Washington Hearing Aid Center, which was established in 1953. Our business located in Seattle, provides hearing testing, hearing aid selection, fitting sales and services. We employ eight individuals.

My written testimony describes the activities of my largest and most blatant tax-exempt competitor, the Northwest Speech and Hearing Center. It tells you that in 1979, just 3 years after commencing its hearing aid sales program to nonhospital patients which was among the first in the Nation, the hospital's clinic was grossing $1 million and had showed profits of $161,000.

What it didn't tell you was that in that same year my net sales were down almost $19,000. Unfortunately, 1979 was not a unique year for my business but only the beginning of what I fear will eventually result in its demise. In point of fact, between the years 1982 and 1986 my net sales have plunged approximately $100,000.

Hearing aids are a classic example of a commercial activity that should not be subsidized through tax exemption. The private sector has adequately provided these services for some 50 years while tax-exempt providers only entered the marketplace 11 years ago. We, my tax-exempt competitor and I, provided the same hearing aid services to the same hearing impaired population. We both serve those able to pay as well as the indigent.

Despite claims made earlier in these hearings price cutting does indeed exist. Lower pricing is a major factor in the marketing techniques of my tax-exempt competitors. While capitalizing on the halo effect they boast they can offer lower prices because they are a nonprofit organization. Please understand the devastating impact this is having upon my profession and more important on those we serve, the hearing-impaired public.

Tax-exempt commercial hearing aid enterprises virtually span the Nation, from the Eastern Maine Medical Center in Bangor to the West Texas Rehab Center in Abilene, to the Northern Rocky Mountain Easter Seal Clinics in Montana. Tax exempt organizations are utilizing established commercial techniques to sell hearing aids and reaping sizable untaxed revenues in the process.

The time has come for a complete overhaul of the treatment of nonprofits in the Internal Revenue Code. Abuse of the unrelated business income tax is the tip of the iceberg. I offer for your consideration the following recommendations, first, treat like activities in a like manner by granting exempt status for the activity and not the organization. Second, restructure the 501(c)3 sections of the Internal Revenue Code so they reflect the original legislative intent and conform with the realities of today's socioeconomic needs.

Unless steps are taken soon the outcome is inevitable. Tax-exempt clinics, hospitals and universities will soon monopolize the sale of hearing aids. Tax-paying businesses such as my own will cease to exist.

We believe that Treasury recommendations are a necessary realistic beginning to tightening the unrelated business income tax. But we do not believe they address the problem of unfair competition. In conclusion, Mr. Chairman, the National Hearing Aid Society will be submitting detailed responses to your specific questions for the record. Thank you.

[The statement of Ms. Holm and attachment follow:]

STATEMENT OF ROBIN HOLM, PRESIDENT-ELECT, NATIONAL HEARING AID SOCIETY

My name is Robin Holm. Along with my husband John, I own and operate the Washington Hearing Aid Center in Seattle. Established in 1953, our business provides comprehensive hearing testing services and hearing aid selection, fitting, sales and servicing. Presently we operate an office in downtown Seattle and have 8 employees.

Additionally, I am the President-Elect of the National Hearing Aid Society (NHAS). This group is the professional association of hearing aid specialists—small business people such as myself. I understand that the National Hearing Aid Society will be submitting a written statement to the Subcommittee which addresses the technical intricacies of this issue. It is not my intent to even summarize that submission . . . quite honestly I don't really understand it! So rather than talk to you about "exempt purpose," "unrelated business income" and such, I want to tell you about something I've got a lot of experience with—the burgeoning hearing aid sales promotion by tax exempt clinics and hospitals and the resultant impact on taxpaying providers.

Prior to 1976 there were no tax exempt clinics or hospitals in the metro Seattle area selling hearing aids. Don't believe for one moment that this meant my husband and I had a monopoly; far from it. We had some 15 competitors, all tax paying competitors. We competed vigorously, but fairly. It was a shining example of our American free enterprise system at work. Sadly such is no longer the case.

In 1976, Northwest Speech and Hearing Center became the first tax-exempt hearing aid sales outlet in Seattle. It has subsequently been joined by Highline Community Hospital and the Hearing, Speech and Deafness Center (a United Way agency), among others. The common perception of non-profit organizations as altruistic servants to the community is shattered by these profiterring provacateurs. Allow me to give you an example.

The Northwest Speech and Hearing Center is a tax-exempt clinic affiliated with a tax-exempt hospital in Seattle. Since beginning its hearing aid sales activities in 1976, Northwest has provided a model for its tax-exempt brethren on how to blatantly promote and sell huge numbers of hearing aids—all shielded from taxation. Further, the director of the Northwest Speech and Hearing Center has emerged as a nationally recognized proponent of commercial hearing aid sales as a vehicle to obtain substantial tax-sheltered profits. Figures made public by the director himself indicate that in less than six months of commencing its hearing aid sales program Northwest had turned a program losing at least $14,000 a year into a moneymaker. By 1979, Northwest was grossing $1 million annually and showed profits of $161,000.

How is this possible, you ask? Quite simple, as I see it. Northwest promotes its product in the precise manner of a commercial enterprise, yet enjoys the full benefits of tax-exempt status. If you doubt my claim that Northwest operates in a commercial manner, be aware that they have utilized an organization that trains Washington real estate agents to improve their staffs' sales techniques. This slickly trained sales force has at its disposal mobile testing vans loaded with up to $70,000 in donated equipment. These vans do hearing testing at fairs, shopping centers, anywhere a potential heaing aid purchaser may be found. The entire Northwest hearing aid sales operation is augmented by a substantial promotional and advertising campaign, much of it based upon the utilization of public service announcements. I could go on, but I think the point has been made—beneath the veil of tax-exempt status there dwells a commercial, moneymaking business which pays no taxes.

Northwest Speech and Hearing Center is not an isolated example. As president-elect of the 4,000-plus member National Hearing Aid Society, I have been painfully aware of the epidemic nature of this pox upon our free enterprise industry. Nonprofit enterprises, which are now unfairly utilizing their advantages in competing with tax-paying hearing aid businessses, virtually span the nation—from the Eastern Maine Medical Center in Bangor, to the Central Florida Speech & Hearing Center in Lakeland, to St. Luke Methodist Hospital in Cedar Rapids, Iowa, to the West Texas Rehab Center in Abilene, to the Northern Rocky Mountain Easter Seal clinics in several Montana cities, to the Alaska Treatment Center in Anchorage. The list continues. In every corner of our nation, tax-exempt organizations are utilizing established commercial techniques to sell hearing aids and reaping sizeable revenues in the process.

Unless steps are taken soon, the outcome is inevitable. The advantages I've described will result in tax-exempt clinics and hospitals monopolizing the sale of hearing aids. Tax-paying businesses such as mine will cease to exist. This trend has already begun. Over the last 10 years countless hearing aid specialists in my home state of Washington and elsewhere have closed their doors, due in large measure to these blossoming tax-exempt competitors. Please understand the devasting impact this is having upon my contemporaries, my profession, my very existence. And most importantly, the well-being of these we serve—the hearing-impaired public.

I will not presume to present specific remedies to this dilemma for certainly the scope of this issue exceeds my somewhat parochial perspective. A perspective that, I must add, was broadened significantly when I had the distinct honor of serving as a delegate to the 1986 White House Conference on Small Business. At that event I gained a great deal of understanding for how many other fields face increasing competition from tax-exempt rivals. Moreover, I came to appreciate the need for a comprehensive review of and solution to this issue. I ask that this Subcommittee recognize the severity of this situation and that you promptly and forthrightly bring the resources and authorities at your disposal to craft a resolution. Thank you for your understanding.

[The following was subsequently received.]

NATIONAL HEARING AID SOCIETY COMMENTS CONCERNING UNFAIR COMPETITION BETWEEN TAX-EXEMPT ORGANIZATIONS AND TAXPAYING SMALL BUSINESSES, BY WILLIAM J. TOBIN, LEGISLATIVE COUNSEL

1. 501(c)(3) organizations comprise 43 percent of all tax-exempt organizations, and dominate the tax exempt community in total revenue and total assets. Their health and eductional activities represent their largest source of revenues.
2. Escalating expenses, declining revenues and excess capacity have forced many tax exempt organizations into the commercial arena.
3. "Commercial activities" of tax exempt organizations generally are more businesslike with regard to marketing and the pursuit of profit.
4. Many activities (not purposes) of many tax-exempt organizations no longer can be characterized as "charitable endeavors."
5. The tax-exempt sector has gained marketshare and it is easier to document their gain, rather than the small business loss, which often is highly localized.
6. Contributing to the unfair commercial advantage of tax exempt organizations are certain tangible and intangible resources: the "halo effect", i.e. perception as a "goodwill" organization; exemption from federal, state and local taxes, including unemployment compensation coverage; advantageous postal rates; access to reduced cost mailing lists and public service announcements; "captured referrals"; use of donated equipment, facilities, and volunteers; and the development of "layered" corporate structures where the tax-exempt entity is treated as an affiliate or subordinate, while operating at one location, etc.
7. According to the latest available data, of the 350,000 tax exempt organizations who file Form 999 (i.e., with annual revenue above $25,000), only 27,000 file Form 9990T, reporting unrelated business income.
8. This is not the time for further study or conceptual reflection. The NHAS has concrete, documented examples of unfair competition from tax-exempt clinics that have devastated their small business, hearing aid distributors.
9. The "relatedness test" for the unrelated business income tax is virtually impossible to apply and enforce, and in many cases is not the relevant issue.

RECOMMENDATIONS FOR LEGISLATIVE ACTION

A. Reverse the current presumptions. Wherever profits result from the regular, commercial activities of tax exempt organizations, and there exists a for-profit competitive market for those goods and services, they should be viewed as taxable.

B. Attention should be focused on the nature, content, manner and extent of the activity conducted by the tax exempt entity, rather than its purpose.

C. The taxable presumption can be rebutted by the tax exempt organization.

In sum, let fair competition take place where neither party is subsidized and both parties pay their fair share of taxes. (The state, local and unemployment tax situation of tax exempt groups needs to be addressed elsewhere.)

STATEMENT OF THE NATIONAL HEARING AID SOCIETY ON UNFAIR COMPETITION BETWEEN NON-PROFIT ORGANIZATIONS AND TAX-PAYING SMALL BUSINESSES, BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES

BY JAMES P. LOVELL, GOVERNMENT RELATIONS DIRECTOR
JUNE 1987

INTRODUCTION

This statement is presented on behalf of the National Hearing Aid Society (NHAS), a national trade association representing approximately 4,000 hearing aid specialists/dispensers (hearing aid specialists) in the United States and abroad. NHAS was founded over thirty years ago to ensure the provision of competent professional assistance to the more than twenty million Americans who suffer from hearing impairments. As the principal accrediting body for persons engaged in the testing, selection, fitting, sale and servicing of hearing aids, NHAS administers a demanding certification program and conducts study courses and seminars to keep its members current on developments in the field.

NHAS and its individual members are committed to working closely and cooperatively with allied members of the hearing health care profession in order to provide the best possible service to the nation's hearing impaired. NHAS is concerned that the commercial sale of hearing aids by certain tax-exempt organizations, has resulted in unfair competition between different members of the hearing health care delivery team, and has directly threatened the livelihood of its individual members.

NHAS, believes that many tax-exempt organizations, including universities, clinics and hospitals, have engaged in the promotion, marketing and sale of hearing aids in direct and unfair competition with hearing aid specialists who primarily operate small businesses. This has resulted in a trend to eliminate the role of the hearing specialists in the sale and dispensation of hearing aids and the erosion of the current free enterprise delivery system.

While NHAS does not contend that every tax-exempt hospital or hearing clinic engaged in the sale of hearing aids does so for other than charitable purposes, there is growing evidence that many such organizations have attempted to capture and control the hearing aid market. This goal is clearly a substantial non-exempt purpose which should be considered in examining the exempt status of such organizations.

EXAMPLES OF ACKNOWLEDGED, BLATANT, UNFAIR COMPETITION

Let me cite a somewhat renowned and a egregious example of this unfair competitive campaign. John Maher, Director of the tax-exempt Northwest Speech and Hearing Clinic (Northwest Clinic), affiliated with the Northwest Hospital in Seattle, Washington, is considered one of the foremost authorities on successfully establishing clinics to sell hearing aids in tax-exempt settings. He has written several articles and toured the country, lecturing on how to develop a profitable hearing aid sales operation within the setting of a tax-exempt organization, and to expand the market for the clinic's services. The key to success is, in Mr. Maher's word -- MARKETING.

As a result of Mr. Maher's marketing and promotional techniques, the Northwest Clinic expanded its total patient service from 270 individuals in 1970 to over 9,000 in 1980. Correspondingly, the clinic's gross revenues climbed from $60,000 to more than $1 million in 1979, with a net profit of $161,000. In 1970, the clinic employed one part-time audiologist; by 1980, the audiological staff grew to 42.

As a tax-exempt agency, the Northwest Clinic has also qualified its clinic as a "rehabilitative agency" which entitles it to Medicaid/Medicare records for all area convalescent homes. As a result, Maher today has thousands of beds in convalescent homes under contract for audiological services.

While Maher has marketed and promoted the sale of hearing aids at his tax-exempt clinic as aggressively as any tax-paying hearing aid specialist, he has admitted that his tax status protects and softens the public perception of his marketing strategies. With mobile vans, armed with donated equipment costing approximately $70,000, he has toured county and state fairs, and shopping malls, to test hearing and sell hearing aids. He even has utilized an organization that trains Washington real estate agents to improve his staff's slick sales techniques. The sales operation is augmented by a substantial promotional and advertising campaign, much of it based upon the utilization of public service announcements.

Tax-exempt organizations are generally precluded from showing more than a de minimis profit in any taxable year without inviting a skeptical audit by the Internal Revenue Service. That prohibition, however, has not stopped the imaginative Mr. Maher from disguising his profits and plowing them back into ever increasing salaries, product inventory and expanded operations.

In short, the Northwest Clinic has been transformed into a major hearing aid center, engaging in sales on a scale substantially larger than necessary for the performance of its exempt functions and, in fact, dwarfing the original purpose for which it was ostensibly organized.

NHAS further submits that the Northwest Clinic does not stand alone in it exploitation and abuse of its tax-exempt status. NHAS suggests that there are scores of other such clinics engaging in or contemplating the same kinds of activities. In fact, in the Seattle area alone, the Highline Community Hospital and the Hearing, Speech and Deafness Center (a United Way agency) have joined Maher's Northwest Clinic in aggressive sales ventures. The common perception of non-profit organizations as altruistic servants to the community is shattered by these profiteering provocateurs.

Another example of apparent unfair competition in the audiology services field was the 1984 decision of the Northern Rocky Mountain Easter Seal Society to expand its services into the hearing aid dispensing field. The decision was based on shrinking funding sources that made it "imperative to seek outside revenue generators." This course of action had been recommended by an outside consultant from the Portland (OR) Center for Hearing and Speech, who had already achieved a sizable income over expenses for his Center. It also was expected to provide greater financial stability and greater job security.

It was reported that the National Professional Advisory Committee of the National Easter Seal Society had unanimously endorsed this decision to expand services.

In the Northern Rocky Mountain Easter Seal effort, all goods were to be handled in a business-like manner and were to reflect the "low end" of Montana average, hearing aid dispensing, cost figures.

The ultimate fiscal objectives of this competitive campaign were increased revenues to reduce significantly a $30,000 projected audiological deficit. Moreover, the outside consultant recommended that the $280 cost for a hearing aid include a $100 mark-up or profit, that would result in a $40,250 annual profit for two Easter Seal Centers alone.

Are these isolated examples? We think not. Many clinics also tout that they are United Way agencies./1

The problem of unfair competition, it should be noted, is national in scope but local in impact, because we are dealing with highly localized small business service firms. Aggregate national sales figures do not fairly portray these devastating, localized impacts./2

Having provided only two of many examples of unfair competition between taxable businesses and tax-exempt organizations in the hearing aid field, let me put this into the broader context of the big picture of unfair competition.

COMPETITION BETWEEN TAXABLE SMALL BUSINESSES AND TAX-EXEMPT ORGANIZATIONS

According to the recently published U.S. General Accounting Office (GAO) report, Competition Between Taxable Businesses and Tax-Exempt Organizations, in 1985 organizations classified by the IRS as 501(c)(3) entities comprised 43% of all tax-exempt organizations, a total of 366,071 such

---

1/ The sale of hearing aids by tax-exempt organizations literally spans the nation -- from the Eastern Maine Medical Center in Bangor, Maine and the Central Florida Speech and Hearing Center in Lakeland, Florida to St. Luke's Methodist Hospital in Cedar Rapids, Iowa, to the West Texas Rehab. Center in Abilene, Texas to the Alaska Treatment Center in Anchorage. Moreover, Easter Seal affiliates in Austin, Texas and Sioux City, Iowa also are selling hearing aids agressively.

2/ Some have sought to minimize the amount of actual sales of hearing aids by tax-exempt organizations by referring to a 1986 study by the International Trade Commission (ITC), "An Assessment of the Impact of Imports Under the Educational, Scientific, and Cultural Materials Importation Act of 1982, Public Law 97-446, on the U.S. Hearing Aid Industry" that seems to indicate that during 1984 only approximately 43,800 hearing aids or 4% of the total U.S. hearing aid market were distributed to tax-exempt entities. However, a 1987 GAO report, "International Trade: Observations on the Operations of the International Trade Commission," questions the validity of ITC statistical reports in general: "ITC in its questionnaire analysis uses incomplete and unverified data. More specifically, we found that (1) ITC questionnaires may contain format weaknesses, (2) sometimes the response rates are low on the entire questionnaire or on certain questions, (3) ITC's investigative field work was limited, and (4) investigative reports lack summaries and generally do not set forth the scope and methodology of the investigations" (p. 10). The GAO criticized the ITC sampling procedures and cited typically low response rates (p. 14).

entities. They are dominant both in their share of the tax-exempt community's total revenue and total assets. (p. 5). Moreover, health and educational activities represent the most dominant sources of revenue (p. 16). The GAO notes: "As tax-exempt organizations have evolved over the years in terms of number and activity, many appear to have become generally more reliant on income-producing or commercial activities and less reliant on support from contributions, government grants and dues." (p. 18, emphasis added.)

The GAO, also, made an interesting distinction between "income-producing" activities, which are generally less profit-oriented, and "commercial activities," which generally are more businesslike with regard to marketing and the pursuit of profit. (p. 2, footnote.)/3 For the purposes of our presentation, the NHAS will focus on those commercial activities of the tax-exempt sector.

Moreover, many observers have indicated that escalating expenses, declining revenue, and excess capacity have forced many tax-exempts into the commercial arena. Tax-exempts are professionally operated, and sophisticated management will adapt to maximize resources and compete utilizing their organization's strengths.

Contributing to this unfair commercial advantage are certain tangible and intangible resources possessed by tax-exempts that are not available to taxpaying firms. Among these are:

- the so-called "halo-effect" by which the non-profit organization is perceived as "healing the sick" or providing resources to the needy as a "goodwill" organization (think of the United Way agencies such as the Easter Seal compaign);
- exemption from federal, state and local income and property taxes, including unemployment compensation coverage of current employees (unlike the hearing aid dispenser that must pay these taxes);
- advantageous postage rates (especially, at third-class, non-profit rates);
- the availability of volunteer, non-paid help;
- the ability to receive tax deductible donations of services, goods, contributions and incurred expenses (consider the use of audiology testing equipment provided at government expense);

3/ In its February 1987 report, the GAO listed factors that indicate the commercial nature of the activity of tax-exempt organizations:

1. Price is below market of that of similar activity performed by taxable businesses;
2. Price is competitive with that of similar activity performed by taxable businesses;
3. Activity or service is offered to the general public;
4. Activity or service goes beyond that required to achieve the exempt purpose of the organization;
5. Activity is widely advertised, such as through direct mail, newspaper, radio ads, and magazines;
6. Target market is largely similar to that served by taxable business.

(P. 75, Appendix XI.)

-- access to mailing lists, at least at reduced costs;

-- improper use of facilities, equipment, staff or supplies that have been paid for by governments or charitable donations (consider clinics run under university hospital auspices);

-- lower liability insurance rates;

-- the use of surplus funds to expand; and, above all,

-- "captive referrals" where clients receiving one service from a tax-exempt firm are referred to in-house operations for other services (rather than to an outside provider, who gets no referrals except by word of mouth and the "Yellow Pages")./4

There are other factors which may contribute to an unfair competitive edge for tax-exempt entities. They are able to receive income from multiple sources under one exempt umbrella which enables such firms to charge below market (or even below cost) price for services provided. The actual cost charged a client may not recapture all costs, which may have been spread among several revenue streams, e.g., government grants, tax free bonds, low interest loans, charitable donations, etc.

According to a study prepared for the Pennsylvania State Legislature, some non-profit firms, particularly hospitals, have carried the concept of using resources, generally unavailable to taxpaying firms, to a different and new level by creating new corporate structures, in which the original tax-exempt organization becomes only one of many corporate entitities, both tax-exempt and taxpaying. Thus, a new tax-exempt corporation is established as the parent corporation with the original tax-exempt entity (a hospital) treated as either an affiliate or a subordinate tax-exempt entity. In many instances, a taxpaying entity also is created so that activities which are outside the guidelines of the Federal tax code can be fragmented.

"Layered" corporate structures can protect the revenues and assets of the original tax-exempt entity, can attempt to limit the liability of the original entity and can channel profits back to the tax-exempt parent. The tax-exempt parent then can draw out funds from the affiliate or subsidiary by charging administrative fees, receiving rental income from property or equipment, making loans and collecting interests, receiving charitable donations from the taxpaying affiliate, or receiving in-kind assistance from the taxable entity. To add

---

4/ The February 1987 GAO report listed certain factors that contribute to an advantage for tax-exempt organizations.
1. Exclusion of earnings from federal income tax;
2. Reduced cost or free postage;
3. Reduced cost or free advertising;
4. Subsidization of competitive activity by tax-exempt facilities, personnel, etc.;
5. Government subsidy, e.g., grants, facilities, etc.;
6. Exclusion from regulatory requirements;
7. Exclusion from state and local property and other taxes;
8. Goodwill associated with tax-exempt status.
(P. 75, Appendix XI.)

to the competitive confusion, both taxpaying and tax-exempt activities of a parent/affiliate or subsidiary may be mixed at one location, thus often making it impossible to arrive at a fragmented activities formula for property and other taxation.

Not surprisingly, the National Assembly of Voluntary Health and Welfare Organizations acknowledged in 1985 that competition between the tax-exempt and taxable business communities appears to be escalating and has grown much more complex. This is in line with the view of the taxable small business community.

In June 1984, representatives of the leading U.S. small business organizations held a Small Business National Issues Conference in Washington, D.C. Their second highest concern, after the immensity of the Federal deficit, was ". . . excluding commercially competitive activities of non-profits from tax exemption." Again, at the August 1986 White House Conference on Small Business, the delegates' third highest recommendation (with 1267 votes out of 1715 ballots cast) dealt with the protection of small businesses from damaging levels of unfair competition: ". . . federal, state, and local laws, regulations and policies should: a) Prohibit unfair competition in which non-profit, tax-exempt organizations use their tax-exempt status and other advantages in selling products and services also offered by small businesses . . . . Thus, . . . tax exempt entities should not be permitted to use their tax return or postal rates to compete with commercial providers of products and services."

UNRELATED BUSINESS INCOME TAX (UBIT)

In 1950, explicitly recognizing the problem of the alleged unfair competitive advantage enjoyed by certain tax-exempt organizations when competing with taxable businesses (and to capture potential tax revenue and avoid tax-exempts purchasing taxable businesses to operate them in a tax-exempt manner), the Congress established the Unrelated Business Income Tax (UBIT). This was to be imposed on the income of tax-exempt organizations derived from activities not substantially related to the exempt purpose of the organization. Prior to 1950, all income of tax-exempt organizations was considered exempt from tax, even if the nature of the activity that produced the income was not related to the organization's purpose./5 By 1984, the GAO reported that 22,279 tax exempt organizations reported engaging in taxable unrelated activity. (However, one wonders if this is only the tip of the concealed iceberg.) In fact, in 1986, one-half of the UBIT taxes of $57 million paid came from only two tax-exempt organizations.

Here the UBIT comes into play. It was intended to impose equal tax treatment upon unrelated, commercial activities of tax-exempt organizations and the activities of taxable businesses.

As related to the problem before us, UBIT is imposed by the IRS Code in:

5/ This was especially true if the destination of income test was met, i.e., income generated from any source, including the acquisition of profit-making businesses, was considered exempt, if the net profits were devoted to activities that were recognized as exempt. However, Congress explicitly ended the validity of this test in 1950.

-- Section 511 - provides for the UBIT upon unrelated business taxable income;

-- Section 512 - defines unrelated business taxable income; and

-- Section 513 - defines an unrelated trade or business.

According to IRS regulations, therefore, an activity is subject to the UBIT:

-- if it is a trade or business, i.e., generally any activity carried on for the production of income from the performance of services or sale of goods;/6

-- if it is carried on regularly, i.e., similar in frequency, continuity and manner of pursuit to the commercial activities of a non-exempt, taxable business; and

-- if it is not substantially related to the organization's exempt purpose, i.e., if there is no causal relationship between the business and the exempt purpose. The relationship is substantial if the business contributes importantly to the exempt purpose, other than by the production of income./7

In addition, the 1950 legislation specifically provided exclusion from consideration as unrelated trade or business if the activity was performed without compensation, if it consisted in the sale of merchandise, substantially all of which had been contributed, or if it was carried out by a 501(c)(3) organization primarily for the convenience of its members, students, patients, officers or employees.

In the practical order, however, IRS officials have observed that the UBIT is quite difficult to administer due to

---

6/ Activities such as producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Thus, for example, the regular sale of pharmaceutical supplies to the general public by a hospital pharmacy does not lose identity as trade or business merely because the pharmacy also furnishes supplies to the hospital and patients of the hospital in accordance with its exempt purpose . . ." Reg. §1.513-1(b). (Emphasis added.)

7/ "In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business." Reg. §1.513-1(d)(3). (Emphasis added.)

the individual circumstances to be considered in determining whether an activity is related substantially to an exempt purpose. Oftentimes, also, it is difficult to account for the revenue and expenses associated with the unrelated activity, especially when there is a commingling of related and unrelated business activities (cf GAO Report, pp. 24-25).

Nevertheless, competition from tax-exempt organizations can result in certain, identifiable economic impacts on taxpaying businesses, e.g.:

-- reduction of potential markets;

-- reduction of current or prior markets;

-- decreased profits; and

-- required layoffs, or other curtailment of operations.

(GAO Report, p. 76, Appendix XI, n. 21.)

IMPACT AND MEANING OF REVENUE RULING 78-435

Totally muddying the waters in the area of hearing aid competition was an IRS Revenue Ruling issued in 1978. Based on the facts presented to it, the IRS ruled that the sale of hearing aids to its patients by an exempt hospital, whose primary activity is rehabilitating the handicapped, including those with hearing deficiencies, is not unrelated business./8

The impact of this ruling was devastating, inasmuch as many tax-exempt hospitals operating hearing clinics and many independently operated tax-exempt hearing clinics interpreted the ruling as an across-the-board authorization by the IRS to commence operation of retail businesses selling hearing aids in direct and unfair competition with tax-paying entities. In reality, there was a glut in the market for clinical audiologists, and audiologists needed to sell hearing aids to generate the income necessary to survive and make their clinics self-supporting and profitable. Prior to this situation, sales by audiologists had been considered unethical. It was the hearing aid specialist who performed basic testing and fitting services for hearing impaired persons, when amplification was indicated.

As a practical matter, however, Rev. Rul. 78-435 came to be interpreted as implying that the sale of hearing aids by an audiology clinic was always an exempt-function activity, regardless of (1) the price at which the hearing aids are sold, (2) the gross profit derived by the clinic from sales and related services, (3) the commercial availability of hearing aids and related services in the community ostensibly served by the clinic, and (4) the magnitude of the clinic's sales operations and the promotional means utilized.

8/ Prior to the August 23, 1977 Revenue Ruling, the applicant changed the ultimate sales audience from "members of the community and the surrounding areas" and "not restricted to any specific population" (letter to IRS dated June 24, 1977), to "all individuals receiving service from the Center must be Center patients, referred by the medical doctor or institution." (Letter dated July 5, 1977.)

Questions still remain, however, about who is to be termed a "patient" and who is a "customer." Bearing in mind that the commercial hearing aid provider routinely performs many services for the hearing aid customer which also may be performed by persons on the staff of a tax-exempt hearing clinic, some clarifications may be found in analogous rulings related to hospital pharmacies and testing labs, e.g. (emphases added):

-- Sale of pharmaceutical supplies by an exempt hospital to private patients of physicians with offices in a hospital-owned medical building is unrelated business (Rev. Rul. 68-375);/9

-- Prescription sales by an exempt hospital pharmacy to private patients of an affiliated, non-exempt clinic were UBI. Clinic patients weren't hospital patients. To be exempt income, sales have to be for the convenience of hospital patients, in furtherance of the exempt purpose of the foundation, or incidental to the use of the hospital facilities (Carle Foundation v. U.S. (7 Cir. 1979));

-- Performance of diagnostic lab testing on referred specimens from private patients of hospital's staff physicians is unrelated trade or business, if such services are otherwise available in the community (Rev. Rul. 85-110);/10

-- Hospital's lab services for local physicians' private patients were related to its exempt purposes of providing health care for the community, if it doesn't compete with commercial labs, either because they're not fully equipped to provide such services, or they're not available in the area (Ltr. Rul. 8124006; Ltr. Rul. 8124076);

-- Exempt hospital's income from prescriptions sold to private patients of staff doctors was not UBIT. The purpose of the hospital was to provide medical services to rural area. Pharmacy was one of many benefits used to entice and hold doctors. Sales to general public were taxable unless shown to be occasional (Hi-Plains Hospital v. U.S. (6 Cir. 1982)).

Hence, let us make the following conclusions in the form of four principles:

1. An organization which actively promotes its products and services in competition with existing commercial enterprises, should not be exempt as a 501(c)(3) organization;

9/ See also Rev. Rul 68-374 and 68-376 regarding clarifications about "patient" status.

10/ See also Rev. Rul. 85-109 where the IRS held that a tax-exempt hospital's performance of laboratory testing upon referred specimens from private patients of the hospital's staff physician for their convenience was an unrelated trade or business because the staff physicians were not members of the hospital.

2. The sale by a hearing clinic of otherwise commercially available hearing aids and hearing aid services to persons who are not patients of the clinic constitutes a trade or business under Section 513 of the Code;

3. A person does not become a "patient" of a hearing clinic by attending the clinic for the purpose of obtaining an otherwise commercially available hearing aid and related testing and fitting services; a person becomes a "patient" by attending the clinic, upon referral of a physician, for the purpose of obtaining specialized diagnostic services, the performance of which is the unique function of the audiology clinic in the hearing health care community; and

4. Even if a hearing clinic sells hearing aids to persons who are considered "patients," as described in the latter part of (3), such sales are not automatically immune from the unrelated business income tax, if the clinic's pattern of activity indicates that the sales are not primarily for the convenience of the patients but, rather, are intended to produce revenue to support the clinic.

Accordingly, under the applicable sections of the Internal Revenue Code, the income of an exempt organization is subject to the unrelated business income tax: (1) if it is derived from the operation of a "trade or business," (2) that is "regularly carried on by an organization," (3) which is not "substantially related" to the exempt purposes of the organization, and (4) is not carried on "primarily for the convenience of its members or patients."

The NHAS submits that this precisely describes the competitive situation currently prevalent in this country when tax-exempt clinics sell hearing aids.

CONCLUSIONS AND RECOMMENDATIONS

Thirty-seven years ago, when Congress enacted the Unrelated Business Income Tax provisions, it did so with the explicit recognition that tax-exempt organizations enjoyed an unfair competitive advantage over taxpaying businesses. Not only have these competitive advantages perdured, they have become more complex and more pervasive, e.g., layered corporate structures intermingling tax-exempt and presumably taxable entities. Moreover, the "halo effect" and "captive referrals" add to the competitive edge.

The GAO Report and the testimony of tax-exempt umbrella organizations bear recent testimony to this rampant competitive situation. In the case of our own hearing aid industry, tax-exempt competitors even trumpet their successes and beckon their contemporaries to join them. These competitive situations cannot be arbitrarily dismissed as anecdotes, episodes, minor exceptions, even fantasies.

Assuredly, more precise economic impact data is sorely needed and desired. But Congress should not hide behind the perennial need to do further damage assessments. Drastic local damage to small businesses has taken place and continues to drive them to their knees.

Within the existing framework of IRS regulations and decisions, a series of reverse presumptions could be established. Since the ultimate issue is commercial competitiveness, a type of commerciality test, including the manner of conduct and the magnitude of the commercial or business activity could be utilized./11 The questions to be answered are what are they doing and how, rather than why. Accordingly, we propose that:

(1) Wherever tax-exempt organizations conduct "commercial activities," which are more businesslike with regard to marketing and the pursuit of profit, these should be deemed unrelated business income, unless the tax-exempt organization can prove otherwise;

(2) An organization that actively promotes (advertises) its services and sells its products in competition with existing commercial enterprises is not engaged primarily in exempt function activities;

(3) The burden of proof should be on the tax-exempt organization to demonstrate that the production and distribution of their services and products contributes importantly to the accomplishment of their exempt purpose;

(4) Any type of ongoing business activity that competes with activities of taxpaying businesses should be deemed regularly carried on;

(5) If goods or services are reasonably available to a tax-exempt organizations's members, officers, employees or patients from regular, taxpaying businesses, the provision of those goods or services should not be deemed carried on "primarily for their convenience";

(6) If the size, scope and extent of the commercial activities involved are more than insubstantial, there should be a presumption that they are not related to the nature and exempt function of the tax-exempt organization, i.e., substantial business activities are evidence that they are being conducted for non-exempt purposes.

Thus, a new presumption should be established and enforced: WHEN A TAX-EXEMPT ORGANIZATION GENERATES PROFITS FROM A COMMERCIAL ACTIVITY THAT IS CARRIED ON REGULARLY AND THERE IS AN EXISTING TAX-PAYING COMPETITOR, THOSE PROFITS SHOULD BE PRESUMED TAXABLE, UNTIL PROVEN OTHERWISE BY THE TAX-EXEMPT ORGANIZATION.

Ultimately, however, the IRS Code itself could be modified to eliminate or mitigate at least some of the competitive advantages tax-exempt organizations hold over for-profit businesses (and also, thereby, simplify IRS enforcement responsibilities), such as:

1. Require that no more than a minimal portion of a tax-exempt organization's revenues for a specified period be derived from the active conduct of a trade or business;

11/ In B. S. W. Group, 70 T.C. 352 (1978), the Tax Court declared: "Competition with commercial firms is strong evidence of the predominance of nonexempt commercial purposes."

2. Eliminate the exemption from tax for commercial activities of a tax-exempt organizations carried on primarily for the convenience of its members, officers, employees or patients;

3. Eliminate the exception that allows a commercial activity a business activity carried on by a tax-exempt organization, to be exempt from tax because it is related to the organization's exempt purposes.

The time has come for decisive, just action to reverse, even gradually, the competitive, non-profit tide that has swept away much of the for-profit seashore.

In the hearing aid industry's case, therefore, the relevant medical, diagnostic, therapeutic or preventive health services, provided by an exempt audiology clinic, compromise specialized diagnostic procedures for the purpose of assisting medical doctors in making diagnoses and providing various forms of auditory rehabilitation. An individual who does not attend a hearing clinic for the purpose of obtaining such services, but attends the clinic primarily for the purpose of obtaining a hearing aid or obtaining basic testing and fitting services, is in a position analogous to that of someone coming to a hospital for the purpose of obtaining pharmaceutical supplies from the hospital's pharmacy. He or she is not a patient of the clinic, but a commercial customer. Let this close-captioned message go forth. If a tax-exempt clinic sells hearing aids, let them justly and dutifully pay taxes on their profits.

Finally, the National Hearing Aid Society expresses its deep gratitude to Chairman Pickle, and the Members and Staff of the Subcommittee for holding these important hearings and inviting us to testify about the unfair competition we face from tax-exempt clinics and hospitals. We stand ready to provide any additional information and to work with you to achieve a just and timely solution to this vital problem.

Chairman Pickle. Thank you, Ms. Holm. Now we call on Mr. Simmons.

STATEMENT OF PAUL B. SIMMONS, PRESIDENT, HEALTH INDUSTRY DISTRIBUTORS ASSOCIATION, ACCOMPANIED BY ROBERT H. WILBUR, VICE PRESIDENT FOR GOVERNMENT AFFAIRS

Mr. Simmons. Thank you, Mr. Chairman, members of the committee, I am Paul B. Simmons, president of the Health Industry Distributors Association headquartered here in Washington. With me is Robert H. Wilbur, vice president for Government affairs.

As Ms. Holm said just a moment ago, the UBIT abuse is the tip of the iceberg, especially in the health care field. I have a lengthy statement for the record, probably boring, which I have offered for the record. I would like to summarize briefly some of the peculiar things that happen in the health care industry that don't happen anywhere else in the UBIT argument.

Let me tell you who we are and what we do. We are the wholesalers and in many cases direct providers who supply hospitals, nursing homes, physicians, clinics and home care patients with just about every nondrug product and device used to serve patients in our $450 billion health care system. More than 6,000 hospitals, 20,000 long-term care facilities, a third of a million doctors offices and clinics and the 240 million American people depend to some degree on distribution of these products and our services.

Medical Product Sales magazine, our leading trade journal, did a recent poll that showed that 79 percent of the wholesalers around the country are suffering to some measurable extent from the patently illegal practice by some nonprofit hospitals of reselling goods in the private sector. With respect to nonprofit hospitals, the single most dangerous case in point involves the Robinson-Patman Act and Nonprofit Institutions Act, both of which have unique application in the health care field and are uniquely related to the UBIT problem.

The congressional intent in passing Robinson-Patman was clear—just as it was in passing the UBIT—to assure a level playing field for all businesses at a time when predatory pricing and market domination were rampant. But what is happening because of lax enforcement of the laws and intense bottom line pressures is distorting the medical care products delivery system. Here is the worst case scenario, Mr. Chairman, of what can happen out there in the marketplace.

A hospital will take advantage of the Nonprofit Institutions Act exemption from Robinson-Patman and purchase medical equipment and supplies far in excess of its own needs at prices that can be as much as 40 percent below prices a private sector wholesaler distributor must pay for the same products.

The hospital can turn around and resell some of these products to its own doctors and clinics and individuals in the community sometimes, for a handsome profit which would be a UBIT issue, at other times selling them at or near its cost as a way to curry favor with doctors on its staff to ensure that those doctors will refer patients to the hospital from their private practices and clinics. Or the hospital may also resell those products in the fast growing gray market operating out there by unscrupulous firms that specialize in acquiring deep discounted products for resale.

This gray market is exactly like the gray market in drugs that the oversight subcommittee of the House Energy and Commerce Committee has so effectively dealt with in legislation earlier this year. Is any of this legal? No, and I refer you to my testimony.

It is simply not legal but the problem is that it is not being enforced. Is it happening out there? Yes, 79 percent of my own members are feeling it according to the poll that we have. What are the consequences of it? For government it is pretty obvious, you are losing revenues and losing control over the shape and content of the health care distribution system.

You are also losing respect for the law with gross violations going on out there and nothing is happening.

For manufacturers and hospitals alike, there is exposure to prosecution because they are both vulnerable in this situation. For distributors the implication is obvious, they are going out of business. For patients the implications are less obvious, but no less serious.

When products flow in the gray market we lose traceability.

Hundreds and hundreds of products are recalled every year by the FDA and by manufacturers and if the distribution chain is broken you cannot find them.

What can Congress and the industry do? First if the outcome of these hearings is a renewed sense of urgency on the part of the IRS to clamp down on UBIT violations, then you have done a good day's work.

In the case of nonprofit hospitals for example, I think the IRS should go a little further than it does and look to some related questions like, for example, did the hospital, even if it sets up a for-profit corporation on the side to sell products, did the parent corporation benefit from the Nonprofit Institutions Act and then pass along the discount to its for-profit subsidiaries? Is the for-profit entity benefiting directly or indirectly? Is it housed in Hill-Burton structure, was it built with tax-exempt bonding, is it paying taxes on the property it has? I think the answers to those questions would raise eyebrows—and considerable revenues.

The second thing the Congress might do is consider flatly outlawing any sales of medical care products by any hospital, public or private, just as it is now moving to enact a similar injunction against the resale of drugs in H.R. 1207. We will make our case for such a statute before other committees of the Congress.

Third, Congress could do much to forestall abuse of the act throughout the nonprofit sector if it were to squarely clarify the jurisdiction of the FTC over nonprofit organizations. We shouldn't have to go to court every time we have a problem.

Fourth, the industry itself can do more to police its own operations under the present law. It can enforce no resale clauses in contracts, et cetera. The Health Industries Manufacturers Association earlier this month did move to set up a committee to conduct a member education campaign to acquaint its members with the problem. Thank you very much.

[The statement of Mr. Simmons follows:]

HIDA
HEALTH INDUSTRY
DISTRIBUTORS
ASSOCIATION

National Headquarters—1701 Pennsylvania Ave., N.W., Suite 470
Washington, D.C. 20006 202-659-0050
Government Relations Office—1101 Connecticut Ave., N.W., Suite 700
Washington, D.C. 20036 202-857-1100
Trade Show Office—111 East Wacker Drive, Suite 600
Chicago, IL 60601 312-644-6610

FOR IMMEDIATE RELEASE
JUNE 26, 1987

CONTACT ELIZABETH BECK
VP/COMMUNICATIONS

STATEMENT BY

PAUL B. SIMMONS

PRESIDENT

HEALTH INDUSTRY DISTRIBUTORS ASSOCIATION

HEARINGS OF THE SUBCOMMITTEE ON OVERSIGHT

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

ON THE UNRELATED BUSINESS INCOME TAX

JUNE 26, 1987

Mr. Chairman, Members of the Committee:

I am Paul B. Simmons, President of the Health Industry Distributors Association, headquartered in Washington, D.C.

Preparation of this testimony was aided by Robert E. Barnes, a past chairman of HIDA and chairman of our Product Diversion Task Force who is also Executive Vice President of Durr-Fillauer Medical, Inc., headquartered in Montgomery, Alabama, which operates in 19 States. Also involved was Ben Welch, President and Chief Operating Officer of Colonial Hospital Supply Co., Inc., headquartered in Chicago, Illinois, which operates in 12 States. Other HIDA members representing businesses operating in more than 40 States were also involved.

The Health Industry Distributors Association applauds your decision to hold these hearings on abuses of the Unrelated Business Income Tax and related activities by non-profit organizations which have become de facto competitors with this Nation's private businesses.

Indeed, we welcome this long overdue review of the tax-favored status of one segment of our economy because not only is this 37-year-old statute at issue, but also because, at least in health care, two other decades-old statutes have devolved into major problems that are spreading infection throughout the historic voluntary-vs-private sector relationship.

As Members of this Subcommittee well know, unfair competition from the non-profit corporate sector ranked Number Three in the findings of last year's White House Conference on Small Business. It was preceded in the delegates' concerns only by the general issue of taxation and the critical problem of liability insurance.

For the more than 1,500 members of HIDA and their branches-- most of them relatively small businesses -- unfair competition by the non-profit hospital sector ranks a solid Number One in our concerns. And for good reason. Many of our members are being literally driven out of markets by that competition. They're being killed.

Let me tell you who we are and what we do. We are the wholesalers and, in many cases, providers, who supply hospitals, nursing homes, physicians, clinics and home care patients with just about every non-drug product and device needed to serve the patients of our $450 billion health care delivery system. More than 6,000 hospitals, 20,000 long term care facilities, a third of a million doctors' offices and clinics and, of course, the 240 million people of this Nation depend to some degree on the existence and efficiency and viability of our industry.

And let me tell you that all of those qualities of our industry are increasingly threatened by the very issues before this Subcommittee in these hearings.

Medical Products Sales magazine, a leading trade journal, recently found that fully 79 per cent of the firms which distribute medical products and devices in this Nation -- and most of them are HIDA members -- are suffering to some measurable extent from the patently illegal practice by some non-profit hospitals of re-selling goods in the private sector marketplace.

Other witnesses at these hearings have complained to you about uneven, even non-existent enforcement of the Federal Unrelated Business Income Tax and similar State statutes. And so do we. Others will call for strict adherence to the letter and spirit of such laws. And so do we.

Others will complain that certain non-profit organizations have taken patently unfair advantage in competing with private businesses by using low postage rates, property tax abatements, access to "public service" media spots, tax exempt bond financing, direct Federal capital construction grants, preferential pricing of goods and all manner of other perquisites that have been part and parcel of our society's encouragement of non-profit, charitable groups. And so do we when it comes to the use of such privileges as weapons against private sector businesses.

Indeed, even without hearing all of the other testimony you will have before you in these proceedings, I assume that HIDA and its 1,500 members could easily echo, from our point of view, the thrust of the arguments of any other segment of the private sector facing the kind of unfair tactics that have pitted certain elements of the non-profit sector against the private sector of our economy.

As you know, this Nation's $450 billion health care delivery system represents not only one in nine of all dollars in our Gross National Product but also the single biggest concentration of non-profit organizations and institutions which, ideally, should be working shoulder-to-shoulder with the private sector in delivering -- and enhancing -- quality health care services to the public.

But because of its huge size and diversity, that system is, we submit, where there is the greatest latitude for the kinds of abuses of not only the Unrelated Business Income Tax and related State statutes, but also other Federal laws designed to prevent the very kind of unfair competition at issue in these hearings.

The members of HIDA do not question the intents and purposes of the myriad of Federal and State laws and grant programs enacted over the past 200 years to encourage the viability and growth of the non-profit service sector. We have the world's premier health care system. That's proof positive that these **special** incentives have served the American people well.

But we do question -- strongly question -- the untoward effects that some of these very same laws have visited upon the private sector through thoughtless -- or planned -- violations of their letter and spirit by certain non-profit institutions and feckless or sporadic enforcement of those laws by certain Federal and State agencies.

With respect to non-profit hospitals, the single most dangerous case in point revolves about the Robinson-Patman Act and the Non-Profit Institutions Act, which were enacted at another time -- many decades ago -- for reasons that were good and valid then, if arguably not all that pertinent today.

It is because of the fallout from lax enforcement of those same Acts that we see the kind of complaints -- even panic-- among the private sector that has led to the kinds of serious taxation and related issues that you hearing about today.

Indeed, to get at one of the deepest of the root issues surrounding the profit-making activities of non-profit institutions in health care, one must get at the root causes of why there are such great opportunities for these organizations to make a profit.

Congressional intent in passing Robinson-Patman was pretty clear: to ensure something of a level playing field for all businesses, big and small, at a time when predatory pricing and market domination were rampant.

Equally clear was Congressional intent in enacting the companion Non-Profit Institutions Act which effectively exempted non-profit hospitals and other charitable organizations from Robinson-Patman in the case of products they might purchase for their own use.

The idea was to permit non-profits to obtain discriminatorily low prices from vendors to lower their overhead and thus extend the reach of their services to those unable to afford such services on their own.

These Acts were passed at a time when, for example, a "charitable" hospital was largely just that -- a private institution whose charter included caring for the poor and the old and infirm who had no private means, personal or insurance, to pay for it, and there was, of course, no such thing as Medicare or Medicaid or any of the other score of Federal and State programs that have been put in place since that time.

From a bottom-line point of view, a non-profit hospital of the Thirties and Forties was too often a basket-case. It needed all the help it could get -- including discriminatory prices on the supplies it used to treat its patients.

Today, thanks to Medicare, Medicaid and private sector health insurance, that bottom line is far closer to that of a private, profit-making hospital -- and yet still the discriminatory prices are available. Still they are used. And, most significantly, now they are being abused as some of these hospitals scramble to find new ways to stretch their dollars and improve their bottom lines in the wake of the 1983 implementation of the Medicare prospective payment system.

As the Ways and Means Committee had more than a little to do with enactment of that revolutionary system, I know you are quite familiar with just how radical a change that was. But you may not be so familiar with the enormous, and deadly, economic fallout that this new system is visiting on the private health care sector.

This new payment system has produced intense pressures on all hospitals -- pressures not only on their bottom lines but also new pressures to scramble in the marketplace to find enough patients to fill empty beds.

It is a new world in the hospital industry -- and some institutions are striking out in new directions to make their way in it.

Here is a "worst-case" scenario of what can happen out there in the marketplace -- a scenario that, as I said earlier, is happening to at least 79 per cent of HIDA members nationwide:

-- **A hospital takes advantage** of its Non-Profit Institutions Act exemption from Robinson-Patman and purchases medical equipment and supplies far in excess of its own needs at prices that can be as much as 40 per cent below the prices a private sector wholesaler-distributor must pay for those same products.

-- **The hospital then re-sells** some of those products to doctors and clinics and individuals in its community, sometimes making a handsome profit, at other times selling at or near its cost as a way to curry favor with doctors on its staff to ensure those doctors will refer patients to the hospital from their own private practices and clinics.

-- **Or, the hospital might also re-sell** those products on the fast-growing "gray market" operated by unscrupulous firms that specialize in acquiring deeply-discounted products for re-sale to any and all customers. This "gray market" in medical products and devices exactly parallels the "gray market" in drugs that the Oversight Subcommittee of the House Energy and Commerce Committee has so effectively dealt with in legislation earlier this year.

Is any of this legal? No. Not under terms of the Non-Profit Institutions Act and subsequent court and Federal Trade Commission rulings which sharply limit which goods can be resold to whom. The law says: to enjoy the Non-Profit Institutions Act exemption, discriminatorily priced medical products can be bought solely for the hospital's own use or for the personal use of its patients and staff and their staff's families. Period. If the exemption is not planned to protect the original deep discount to the hospital, the discount must otherwise meet a Robinson-Patman defense to be lawful. Period. We believe the exemption and the defenses cannot possibly justify and protect many of the deep discount and diversion situations we see out there.

Such re-sales of deeply-discounted products are for reasons far afield from Congressional intent. Such re-sales do nothing to cut the hospital's operating costs -- unless the hospital profits from them, which is, of course, illegal -- but they do much to undercut the private marketplace. And even if the hospital makes a show of paying any or all of the Unrelated Business Income Tax on such transactions, the revenues can't be anywhere near what government would take in were those same products sold by a private enterprize distributor.

Is it happening out there? Yes. I am submitting for the record a sampling of invoices and advertising broadsides which indicate that the practice is growing rapidly and with apparent impunity to date despite repeated legal alerts from both HIDA and the American Hospital Association among others. I am also submitting the texts of these alerts along with relevant court and FTC rulings on this issue for your information.

What are the consequences for government? For manufacturers? For hospitals? For private sector distributors? And, most important of all, for the patients all of us are supposed to be serving?

For government, the fall-out is obvious: in falling-off of tax revenues, in the flouting of the UBIT and related statues, in gross violations of the Non-Profit Institutions Act and Robinson-Patman Act and in transactions contrary to FTC rulings.

For manufacturers and hospitals alike, there is not only exposure to prosecution -- for both the seller and the buyer may be jointly liable in certain cases of illegal re-sales -- but also the gradual erosion of the nationwide system of distribution of medical care products and devices. For 200 years, our industry has served the health care system well. Indeed, the system of distribution that has evolved over history is one of the great unsung assets that has ensured that quality products are delivered to those responsible for quality care.

For distributors, the implications are obvious. They are increasingly finding that the "level playing field" envisioned by the Robinson-Patman Act is becoming a tilted arena in which they are expected to compete wearing blindfolds with an arm tied behind their back.

For patients, the implications are less obvious but no less serious.

For example, when medical care devices and products flow into the private marketplace through "back-door" re-selling by hospitals, what happens to the traceability of those products in the event of a manufacturer's recall? Each year, hundreds of devices and products are recalled to prevent injury to patients by dint of problems with sterilization, efficacy, operation and so on -- the same kinds of reasons that compel the recalling of drugs.

The normal distribution chain -- from manufacturer to distributor to provider -- has achieved a remarkable record on recalls of potentially dangerous products. When that chain is broken, as is happening with illegal re-sales, so is the capacity to build on that remarkable record.

I would not want to be the father or grandfather of a child who receives an injection or an intravenous solution through a contaminated needle or IV delivery set that had gone through a twisted and extended chain of distribution. Violations of Robinson-Patman or the UBIT pale in comparison to the potential safety risks at issue right now out there in the medical care system.

And what about costs? Are such re-sales passing on discriminatorily low prices to the patient at the doctor's office or clinic? Hardly. In fact, exactly the opposite may be happening out there. Health care cost inflation is still far above inflation in other sectors of the economy.

And, finally, what might Congress and the industry itself do?

First, if the outcome of these hearings is a renewed sense of urgency on the part of the Internal Revenue Service to clamp down on abuses under the UBIT, this committee will have earned the deep gratitude of every sector of the private economy.

We especially urge that the IRS take a long and hard look at those non-profit entities which set up ostensibly for-profit subsidiaries and claim they are paying their full and fair share of taxes.

In the case of non-profit hospitals, for example, which choose to re-sell products through such a for-profit entity, one key question is: did the parent non-profit corporation buy the products at a Non-Profit Institutions Act discount? If so, the transaction should be unlawful: both the deep-discounted original purchase by the hospital, and also the for-profit's purchase, even if at cost, since the for-profit is then masquerading as an entity which can buy at non-profit discounted prices.

Another key question: is the for-profit entity benefitting directly or indirectly from the parent non-profit corporation? For example, is it housed in a Hill-Burton structure? Was it built with tax-exempt bonding? Is it paying property taxes on its structure and the parking spaces it uses to do business? Are both entities fairly and accurately allocating their respective expenses?

Yet another question: does it make sense in today's economy, given Medicare, Medicaid and a host of other support programs, for any non-profit health care entity to keep its exempt status once it begins generating income from for-profit-type operations? Common sense -- and a sense of fairness -- says that no sector of the voluntary economy should be accorded discriminatory tax status once it begins to behave like a for-profit industry.

Why not set a threshold -- set some arbitrary percentage of operating income as the bottom line that separates those entities which pay taxes and those which don't? Should that be 5 per cent? Ten per cent? That's for the Congress to decide-- if it agrees that some objective threshold is appropriate to divide the truly charitable institutions from the predatory.

Why not clarify in the law -- which is in the purview of this committee -- not only what that bottom line is, but also what truly meets the test of what income-generating service is "directly related" to the non-profit entities' "purposes?"

In the case of hospitals, for example, spell it out in the law that yes, it is indeed within the hospital's purpose to serve patients within its walls. But it is clearly not within its purposes to strike out into the private marketplace to sell deeply discounted goods to doctors and clinics and nursing homes. That's what the law now says. But apparently it doesn't say it clearly enough.

Second, Congress should consider flatly outlawing any re-sales of medical care products by any hospital, public or private, just as it is now moving to enact a similar injunction against the re-sales of drugs in H.R. 1207, the Prescription Drug Marketing Act. We will make our case for such a statute before other Committees of the Congress.

We raise the issue here to make the point that the practice of hospitals re-selling supplies bought at discriminatory discounts is one of the very causes of the complaints you are hearing from profit-making companies over abuses of non-profit status in health care.

Third, we believe Congress could do much to forestall endemic abuse of the Non-Profit Institutions Act throughout the non-profit sector if it were to squarely clarify the jurisdiction of the Federal Trade Commission over non-profit organizations. The murkiness in present law on this single, pivotal issue makes it all the tougher for the FTC in particular and the Federal government in general to move quickly and effectively on abuses of the system.

The private sector should not have to keep appealing to the courts to adjudicate wrongs it suffers at the hands of non-profit entities which take advantage of the relative enforcement vacuum that now exists in this area. We believe Congress should make the law more clear and thus make such onerous and expensive court cases unnecessary.

Fourth, the industry itself can do more to police its own operations under extant law. For example, we have requested a Federal Trade Commission staff legal advisory opinion to permit a cross-section of HIDA members to meet with their counterparts from among the manufacturing community to see if we can arrive at a consensus on this issue. HIDA, for one, would like to see more manufacturers follow the law with permissable "no re-sale" clauses in their contracts with hospitals. According to the trade press, several leading manufacturers have already adopted this approach. HIDA believes this approach is very appropriate. We would also like to see all hospitals pay more than lip service to the restrictions of the Robinson-Patman and Non-Profit Institutions Acts.

We were most gratified when the Health Industry Manufacturers Association (HIMA) Board of Directors acted earlier this month to mount a member education campaign on this issue designed to acquaint its 300 members with the legal perils associated with illegal product re-sales and with methods they might employ to combat the practice. This is the most significant development in recent months on this increasingly pernicious problem.

Since we launched an industry-wide campaign earlier this year to alert manufacturers and hospitals to the provisions of current law and their potential liability should they violate those laws, we have seen signs of changes in behavior out there in the marketplace. Many hospitals have stopped the practice of illegal re-sales. Others have stopped short of entering the practice.

But many are flouting the law on the assumption they won't be prosecuted, and in some cases, they may indeed be lucky enough to avoid the kinds of suits many of our members are contemplating.

Fix the law, make violators certain targets of punishment under the UBIT and Non-Profit Institutions Act, and you will have done a great service to our industry and the patients we serve.

We'll be eager -- and proud -- to work with this Subcommittee once these hearings are on the record and you have the factual means to move forward to make the competitive playing field more level than it is today.

From our point of view, distorted purchasing patterns, illegal re-sales of deeply discounted products and unfair tax and subsidy advantages are taking a heavy toll on our economic system.

For-profit entities represent the real efficiencies of our economy. Our search for excellence in health care delivery should not be destroyed by so-called charitable-institution, non-profit competitors, unfairly subsidized by tax or other advantages, who do not so much compete as lay waste to the economic system that produced our non-paralleled health care delivery system.

# # #

Chairman PICKLE. Thank you very much, Mr. Simmons. Now we will ask Mr. Groome to make his statement.

STATEMENT OF HARRY GROOME, PRESIDENT, AMERICAN CLINICAL LABORATORY ASSOCIATION

Mr. GROOME. Thank you, Mr. Chairman.

I am Harry Groome, president of the American Clinical Laboratory Association which I will refer to in the future as ACLA. We, too, have submitted written testimony. For your information ACLA is a national organization of tax paying, independent, clinical laboratories that furnish diagnostic laboratory testing services to physicians to aid them in prevention, diagnosis and treatment of disease. Generally, laboratory testing services are offered by hospital laboratories, physician laboratories, and independent commercial laboratories. These classes of laboratories compete head to head. It is the testing services offered by nonhospital patients by these laboratories that concerns my organization.

I understand, Mr. Chairman, that you wish us to address three specific issues so I will begin with those. First, we have been asked what specific nonprofit income-producing activities have caused ACLA members harm through unfair competition? These activities consist of tax-exempt hospitals providing testing services in direct competition with us to the patients of physicians engaged in nonhospital private practice.

Second, we have been asked to identify what the unfair competition is. When tax-exempt hospitals do not pay tax on the revenues they earn from this activity, they are given an unfair competitive advantage as they do not bear the tax expense that we do.

Third, we have been asked what types of nonprofit organizations are engaging in these activities, the answer is simple, tax-exempt hospitals.

Now, let me supply more details.

Traditionally, hospitals provided laboratory testing services for individuals who were either in-patients or out-patients of the hospital. In either case, the hospital had some relationship with the tested individual. Recently, however, a substantial number of tax-exempt hospitals anxious to attract additional revenues have sought the laboratory testing business of physicians engaged in private practice. This is an emerging trend in the industry.

This is a traditional market of taxpaying commercial independent laboratories. This solicitation is appropriately characterized by the hospitals as outreach testing, as the hospital reaches beyond its walls and holds itself out as available to provide services for patients who are neither hospital outpatients nor outpatients.

Such commercial activity on the part of tax-exempt hospitals constitutes unfair competition when the hospital fails to declare and pay tax on such activity.

Indeed, the IRS has already declared in Revenue Ruling 85-110 that this activity is taxable under the UBIT rules. In 1985 the IRS considered whether a tax-exempt hospital's performance of laboratory tests on referred specimens for physicians and medical clinics not connected with the hospital constituted unrelated trade or business under section 513(a) of the Internal Revenue Code. The patients did not enter the hospital for testing nor did they have any relationship with the hospital.

Commercial laboratory testing services identical to those performed by the hospital were available in the area, and the competing laboratories were equipped to perform the testing and to provide comparable timely service. The IRS found that, one, the hospital received income from the testing that it performed for members of the public who did not otherwise avail themselves of the hospital's medical or diagnostic facilities; two, no substantial causal relationship existed between the hospital's exempt purpose and the provision of testing to nonpatients, and three, the hospital's provision of testing services to these patients was not carried on primarily for the convenience of its own patients.

Accordingly, IRS declared that the providing of diagnostic laboratory testing services to nonpatients constitutes unrelated trade or business for a tax-exempt hospital.

Recently, both large and small laboratories have reported a loss of business from the competition exerted by tax-exempt hospitals. Many independent laboratories are small and competition on the scale presently offered by tax-exempt hospitals may threaten the very existence of some of these businesses.

Thus, I am here to request that the subcommittee take such action as it feels necessary to ensure that tax-exempt hospitals declare as unrelated business income the revenues derived from outreach testing.

The list of suggestions is contained in our written submission, but at a minimum, the current law should be more rigorously enforced. On behalf of our organization, I would like to thank the subcommittee for the opportunity to testify on this important issue.

[The statement of Mr. Groome follows:]

STATEMENT OF THE AMERICAN CLINICAL LABORATORY ASSOCIATION BEFORE THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT CONCERNING THE UNRELATED BUSINESS INCOME TAX

JUNE 1987

My name is Harry Groome, and I am President of the American Clinical Laboratory Association ("ACLA"). ACLA is a national organization of tax-paying, independent clinical laboratories who furnish diagnostic laboratory testing services. As members of the Subcommittee may be aware, the purpose of laboratory testing is to provide physicians with data to aid them in the prevention, diagnosis and treatment of disease. A laboratory may not perform a laboratory test without an order for the test from a physician or other health professional authorized to order tests. Generally, laboratory testing services are offered by three different classes of laboratories: those located in and associated with hospitals ("hospital laboratories"); those located in physicians' offices and operated by or under the supervision of physicians ("physicians' office laboratories"); and those that are independent of both hospitals and physicians' offices ("independent laboratories"). For purposes of the Subcommittee's review of the unrelated business income tax, it is the testing services offered by hospital and independent laboratories that figures most significantly.

Traditionally, hospitals have provided laboratory testing services for individuals who are either inpatients or outpatients of the hospital. In either case, the hospital had some relationship with the individual, whether the individual was actually admitted to the hospital or whether the individual simply visited the hospital outpatient department. In recent years, however, hospitals, seeking additional revenues, have sought to perform laboratory testing on specimens drawn from individuals with whom the hospital has no relationship whatsoever. To this end, tax-exempt hospitals have sought the laboratory testing business generated by physicians in private practice for their patients--the traditional market of tax-paying, commercial independent laboratories. Hospitals obtain this business by aggressively promoting their laboratory services to physicians outside the hospital setting, as well as to other clients of independent laboratories, such as nursing home and industrial accounts. The solicitation of these markets by hospitals is appropriately characterized as "outreach testing," i.e., the hospital reaches beyond its walls and holds itself out as available to provide services for persons who are neither inpatients nor outpatients.

I appear here today to express ACLA's view (a view with which the Internal Revenue Service ("IRS") has already expressed its agreement) that such commercial activity on the part of tax-exempt hospitals constitutes unfair competition when the hospital fails to declare and pay tax on such activity. ACLA accordingly requests that this Subcommittee clarify that the revenues derived from such activity must be declared by the hospitals and taxed as unrelated business income. When hospitals engage in outreach testing without tax liability, they not only threaten the independent laboratory industry, but also deprive state and federal government of substantial tax revenues, revenues to which the government is entitled and which it formerly received from tax-paying independent laboratories.

Cognizant of these problems, ACLA in the past urged the IRS to issue a revenue ruling declaring that the income earned by tax-exempt hospitals from outreach testing constituted unrelated business income, taxable under Sections 511 and 513 of the Internal Revenue Code. ACLA viewed such a ruling as proper because hospital outreach testing is: (1) a trade or business; (2) regularly carried on; (3) not substantially related to the hospital's performance of its exempt purpose or function; and (4) not carried on by the hospital primarily for the convenience of its own patients.

Apparently, the IRS agreed. In Revenue Ruling 85-110, for example, the Service considered whether a tax-exempt hospital's performance of laboratory tests on referred specimens from private office patients of the hospital's staff physicians and of medical clinics not connected with the hospital constituted unrelated trade or business under Section 513(a) of the Internal Revenue Code. The patients themselves did not enter the hospital for diagnostic testing. Commercial laboratory testing services, identical to those performed by the hospital, were available in the area; the laboratories themselves were equipped to perform the testing and to provide comparable, timely service.

The Service analyzed the facts as follows: (1) the hospital received income from the testing that it performed for members of the public who did not otherwise avail themselves of the hospital's medical or diagnostic facilities; (2) no substantial causal relationship existed between the hospital's exempt purposes and the provision of testing to nonpatients; and (3) the hospital's provision of testing services to these patients was not carried on primarily for the convenience of its own patients. Accordingly, the Service upheld the general rule that "the providing of diagnostic laboratory testing services to nonpatients constitutes unrelated trade or business for a tax-exempt hospital."

In light of this ruling, ACLA need not use the Subcommittee's time to establish that the income realized as a result of outreach testing conducted by tax-exempt hospitals constitutes taxable unrelated business income. The IRS has already concluded that such is the case. Rather, ACLA is concerned that, despite the issuance of Revenue Ruling 85-110, a random review of publicly-available 990 Forms indicates that many tax-exempt hospitals engaged in outreach testing still do not file Form 990-Ts as required. Both large and small laboratories have reported a loss of business from the competition exerted by tax-exempt hospitals. Many independent laboratories are small. Competition of the scale presently offered by tax-exempt hospitals may threaten the very existence of some of these businesses.

If the Subcommittee feels that such information would be useful, ACLA stands willing to help the Subcommittee develop a comprehensive list of tax-exempt hospitals that ACLA believes are currently engaging in outreach testing. For the moment, however, I will simply note that ACLA members continue to report incidents of outreach testing by tax-exempt hospitals throughout the country.

Thus, I am here to request that the Subcommittee take any action that it feels necessary in order to ensure that, in compliance with Revenue Ruling 85-110, tax-exempt hospitals declare as unrelated business income the revenues that they derive from outreach testing. ACLA believes that Subcommittee action is necessary because the present-law rules, as interpreted and enforced, may in fact permit unfair competition by exempt organizations.

To rectify this situation, ACLA offers at least the following suggestions: First, while it has been established that the business of outreach testing conducted by tax-exempt hospitals is not "substantially related" to a hospital's tax-exempt purpose, ACLA submits that this standard is vague and accordingly, difficult to administer. ACLA submits that a more precise standard, and one susceptible of ready definition, would be appropriate. Thus, for example, ACLA proposes that any tax-exempt organization that engages in any commercial activity whatsoever be subject to the unrelated business income tax. ACLA further suggests that the Subcommittee explore the feasibility of imposing a minimum tax that tax-exempt entities engaged in commercial activities could pay in lieu of computing their actual taxes. In the alternative, the Subcommittee might wish to develop a policy pursuant to which any tax-exempt hospital engaged in a minimum-specified amount of commercial activity (i.e., as a percentage of its total operating revenues) would be deemed to be operating for other than tax-exempt purposes.

Second, ACLA urges that the Forms 990 and 990-T are not adequate "to identify the type of income-producing activity, the degree of "relatedness" of an activity to an organization's tax-exempt purpose, and other compliance issues." ACLA submits that tax-exempt entities should be required to identify all types of commercial activity in which they engage; it should not be within the organization's discretion to decide those commercial activities that are "related" and those that are not. Moreover, the current forms should be reviewed to determine whether they accurately reflect the total receipts that a hospital realizes from any commercial activity in which it engages. ACLA further proposes that a hospital's failure to report all commercial activity might possibly subject the hospital to civil money and other appropriate penalties for misrepresentation. On a related point, ACLA notes the possibility that even in those instances in which a hospital declares unrelated business income and files a Form 990-T, there may be insufficient safeguards in the existing regulations to ensure a fair allocation of a hospital's expenses to the unrelated business category. Absent specific Subcommittee or IRS guidelines concerning applicable accounting treatment, a hospital's true profits from its outreach activities may be understated, and accordingly, tax revenues lost.

Finally, ACLA suggests that IRS enforcement be strengthened so that tax-exempt organizations that either do not report or mischaracterize their unrelated business income could be readily identified, thus enabling the IRS to take appropriate action against these entities, capture more tax revenues and help turn unfair competition into fair competition.

On behalf of ACLA, I would like to thank the Subcommittee for the opportunity to testify on this important issue.

Chairman PICKLE. Thank you, Mr. Groome.
Now we will ask Mr. Fellman to proceed.

STATEMENT OF GERALD S. OSTROW, PRESIDENT, TEXTILE RENTAL SERVICES ASSOCIATION OF AMERICA, PRESENTED BY STEVEN J. FELLMAN, GENERAL COUNSEL

Mr. FELLMAN. Thank you, Mr. Chairman.

I am Steven Fellman, general counsel to the Textile Rental Services Association of America, a trade association representing over 1,400 taxpaying textile rental companies. Our members rent, maintain and service hygienically clean textile items to customers in industry, commerce and professions.

TRSA is the Nation's leading textile industry association. Our member companies have sales of over $5.2 billion and employ more than 110,000 people. There is a major effort by many in-house nonprofit hospitals to solicit customers away from our for-profit member companies. These hospitals exploit their tax-exempt capital funding and their income tax exemption to obtain an unfair competitive advantage over TRSA member companies that must pay taxes on earnings and generate capital from commercial sources.

My testimony today will describe the nature of the commercial activity of the tax-exempt hospital laundry competitor, the accounting systems used to hide actual costs, the marketing techniques used to solicit business and finally we will make specific recommendations as to how Congress can eliminate the problem of unfair competition.

Most hospitals are built with a good size in-house laundry. Due to a declining population and shorter hospital stays and a designed overcapacity, many hospitals now have 40 to 60 percent of unused laundry capacity. This excess laundry capacity exists at a time when decreased voluntary contributions and increased restrictions on Federal reimbursement payments have resulted in a severe financial strain on the nonprofit hospitals.

To meet this problem, many of the nonprofit hospitals have decided to use their excess laundry capacity to generate revenue. Accounts being solicited include not only other hospitals and nursing homes but restaurants, supermarkets, health clubs, motels, and a full range of linen-supply-type customers. Such accounts are completely unrelated to hospitals or health care, and are normally served exclusively by TRSA member companies.

We have on file the names of over 80 nonprofit hospitals as well as one state penitentiary that are involved in outside laundry services. The number is increasing. Although the IRS code required the hospitals to pay taxes on unrelated business income, in-house accounting systems used by nonprofit hospitals allocated disproportionate amounts of overhead costs such as energy, utilities, et cetera, to their laundry.

As a result, for tax purposes, most of the hospital laundries claim that they operate on a breakeven basis, and therefore don't pay taxes.

How do they market their services? First of all, the prices that they charge are lower than the prices that textile maintenance

---

III. Geographic Location of Outreach Testing

A third question posed by the Subcommittee was whether outreach testing is confined to or more rampant in certain geographic areas. Subcommittee members asked, for example, whether outreach testing is more pronounced in rural areas than in urban areas. Harry Groome, ACLA President, responded that it is common everywhere but may be more intense in urban areas. To fully understand this answer, it should be recognized that laboratory testing provided by independent, commercial, tax paying entities is available throughout the United States. ACLA members offer laboratory testing in virtually every state in the Union. This geographic breadth of service distinguishes laboratory testing from the delivery of most, if not all, other health care services.

All major and many smaller independent laboratories send couriers on a daily route to pick up specimens from and deliver test reports to test-ordering physicians. Specimens are transported from the physician's office to the testing laboratory, and 24 hours later the reports are transmitted from the laboratory back to the test-ordering physician. The specimen may be picked up at a 25, 50 or even 100 mile radius, and either brought to the testing facility or to a collection point where it is consolidated with other specimens and then transported to the testing laboratory.

Using distant laboratories is accepted practice among the physician community; indeed some physicians use laboratories located across the continent. What is most important to the physician is the laboratory's reputation and quality, its method of handling and testing the specimen, and its prices -- not its location. As a result, nearly all communities are now or would upon request from test-orderers be served by one or more independent laboratories.[2] Accordingly, the geographic location of the laboratory neither prescribes or conscribes its marketplace. Competition in general and from outreach testing in particular does appear to be most intense, however, in areas that have large populations, significant numbers of physicians, and numerous hospitals and independent laboratories.

IV. ACLA Response to Treasury Department Recommendations

During the Subcommittee hearings, ACLA was asked to respond to the seven recommendations offered by the Department of Treasury. Although ACLA has not yet had an opportunity to study these recommendations comprehensively or to obtain the benefit of the views of the various tax counsel for ACLA members, we can offer the following general response.

A. Improved Reporting

The first Treasury recommendation is for "more detailed reporting" to improve enforcement and compliance. ACLA agrees with this recommendation. Form 990, at line 78, asks whether an organization had unrelated business income of $1,000 or more during the year covered. If the organization responds affirmatively, it is asked to indicate whether it has filed a Form 990-T. These questions permit an organization to form its own legal conclusion as to the status of any income it has

---

2/ This fact is one that the IRS still does not fully understand. In Rev. Rul. 85-110, the Service suggested that although as a general rule outreach testing is subject to UBIT, in those situations where testing is not "otherwise available" from a commercial, tax-paying laboratory, such testing may be related to a hospital's exempt purpose of providing health care. ACLA suggests that those circumstances in which testing would not be otherwise available are few and far between.

firms must charge. The nonprofits don't have to pay the cost of Federal, State or local taxes, and some don't even pay for water and sewage.

In addition, when figuring prices, they often don't include administrative or overhead costs. As an example, prices quoted by some hospitals for laundry services are as low as 18 cents per pound. These prices bear no relationship to costs or any other criteria, and in some cases, are as much as 50 percent below costs.

All indications are that nonprofit hospitals will continue to solicit laundry business because of increased pressure on the hospitals to generate outside revenues. Thus, these hospitals will be competing unfairly with tax-paying, for-profit textile rental companies.

In search of new ways to generate revenues, nonprofit hospitals are restructuring their corporate identity. While in essence they are creating for-profit corporations, they are using their tax-exempt operations as a base to further their unfair competitive practices. We believe that free competition and free enterprise is essential. We don't believe these institutions, often built with Federal funds and paying no taxes, should be supported further.

Our recommendations are as follows: One, nonprofit hospitals should not be allowed to offer laundry services to any outside entity.

Two, recognized accounting practices must be required for all existing nonprofit corporations engaged in activities generating unrelated business income so that taxable profits can't be hidden.

Three, nonprofit hospital laundries must be required to pay their fair share of local property, sewage and water taxes and other costs.

In conclusion, we are willing to compete fairly but we object to a system that takes our hard-earned tax dollars and uses it to fund a nontax-paying, unfair competitor.

Thank you.

[The statement of Mr. Ostrow follows:]

Statement of Gerald S. Ostrow, President, Textile Rental Services Association of America

My name is Gerald S. Ostrow. I am president of Clean Textile Systems, located in Pittsburgh, Pennsylvania and this year I have the honor of serving as president of our industry association, the Textile Rental Services Association of America. I am testifying today on behalf of the Textile Rental Services Association of America.

I appreciate the opportunity to place before the Subcommittee on Oversight our views and recommendations with regard to the problem of tax-exempt hospital laundries soliciting laundry service from our industry's customers.

The Textile Rental Services Association of America (TRSA),is a nonprofit trade association, which represents over 1,400 textile rental and associate member firms operating in every state in the United States. Member companies rent and service hygienically clean textile items to millions of customers in commerce, industry and the professions. Hospitals, nursing homes, doctors' and dentists' offices, medical and dental clinics, schools and other important human needs institutions, as well as restaurants, hotels, food processing companies, retail stores, etc. are major customers of most textile rental supply companies. TRSA is the nation's leading textile rental industry association. Our member companies have sales of over $5.2 billion and employ more than 110,000 people.

Textile Rental Services Association of America is particularly concerned with competition by nonprofit, tax-exempt organizations in the health care market. There appears to be a major effort by many in-house nonprofit hospital laundries, to solicit customers away from TRSA's tax-paying for-profit member companies. These hospital laundries use their tax-exempt capital funding and their income tax exemption to obtain an unfair competitive advantage over TRSA member companies that must pay tax on earnings and generate capital from commercial sources.

In 1981, the Supreme Court in HCSC-Laundry v. United States, 450 U.S. 1 (1981) upheld the intent of Congress in passing Sections 270(b)(1)(A) and 501(e) of the Internal Revenue Code which provide that a cooperative hospital laundry cannot qualify for tax-exempt status under paragraph 501(c)(3) of the Internal Revenue Code. This decision upholds the law that a tax-exempt cooperative laundry institution established with federal funds cannot provide non-exempt laundry services. Congress passed this statute in recognition that private enterprise can provide a more competitive service than publicly funded laundry entities. However, this law applies only to joint hospital laundries and does not prevent individual hospital laundries from engaging in commercial laundry operations.

Although the Internal Revenue Code does require that the "unrelated" business income of the nonprofit hospital laundries be subject to taxation, in-house accounting systems used by nonprofit hospital laundries can and do mask a significant amount of profit so that for tax purposes, most of these laundries claim that they operate on a "break even basis" and therefore, do not have to pay tax.

My testimony today will describe the nature of the commercial activity of the tax-exempt hospital laundry competitor, the marketing techniques used to solicit business, the accounting systems used to hide actual costs and, finally, I will make specific recommendations as to how the Congress can eliminate the problem of unfair competition from these nonprofit organizations.

I. PROFILE OF THE TAX-EXEMPT COMPETITOR

Textile rental companies are facing increasing competition from nonprofit tax-exempt hospital laundries. Many nonprofit hospitals have in-house plant laundries or own a cooperative laundry in combination with other nonprofit hospitals. Most of these laundries were built with federal funds and usually were designed with built in excess capacity to account for projected increase in need. However, a declining population and shorter hospital stays have left many hospitals with 40 to 60 percent of unused laundry capacity.

Nonprofit hospitals are feeling the same financial strain as trade associations and charities in that a tightening economy leaves less money for voluntary contributions. Furthermore, restrictions on federal reimbursement payments to hospitals are causing an even greater strain.

To meet this financial crisis, many nonprofit hospitals have decided to use their excess laundry capacity to generate revenue. Accounts being solicited include not only other hospitals and nursing homes, but also restaurants, supermarkets, health clubs and a full range of "linen supply" type customers normally served exclusively by tax-paying commercial textile rental companies.

As these hospital laundries are part of nonprofit institutions, they do not pay federal, state or local taxes and some don't even pay for water and sewage. For pricing purposes, they often do not include overhead and administrative costs as part of their laundry costs. As they do not recognize these costs, the prices that they charge for their services can be far below the prices that a profit-making tax-paying business must charge. In fact, there are many cases where hospitals are willing to charge prices below actual costs just to obtain additional gross revenue.

Many of these institutions employ aggressive sales people and use sophisticated advertising and peer pressure to obtain new customers.

TRSA has on file the names of over 80 nonprofit hospitals, including one state penitentiary, that are involved in outside contract linen and laundry service. This number is increasing. Even smaller local hospitals and those that do not operate a "central" laundry operation are looking to their in-house laundry as a means of generating additional funds.

As a trade association, TRSA has advised the Health Care Financing Administration and the Internal Revenue Service of possible misuse of tax-exemptions by organizations which compete with for-profit companies. In addition, in many cases where the Association has been able to obtain the details of nonprofits soliciting laundry services, it has advised the trustees or governing body of the entity concerned that they may be endangering their tax-exempt status. However, the invasion of the commercial market place still continues.

II. MARKETING TECHNIQUES OF COMMERCIAL ACTIVITY BY TAX-EXEMPT COMPETITOR

These nonprofit hospitals often attempt to obtain revenue by offering prices that bear no relation to their real costs. For example, prices quoted for laundry service by one hospital laundry ranged from $.28 to $.45 per pound. These prices quoted bear no relationship to costs or any other reasonable criteria. Often prices are quoted just to obtain additional laundry business volume. In some cases, prices are below costs by as much as 50 percent.

Not only do nonprofit hospitals have an extremely low overhead because of their tax-exempt status, but in pricing their services they fail to use generally accepted accounting principles in determining their costs and also fail to take into account their real overhead expenses. Even if they price their services at a slight margin over what they believe to be their direct costs, on the assumption that this will produce a small cash surplus for their efforts, in reality, such prices are below actual costs as they do not recognize indirect costs common to every commercial enterprise. Furthermore, in-house accounting systems used by nonprofit groups can "hide" costs such as energy (water and sewage), utilities, space, costs of supplies and equipment, administration, and depreciation.

Nonprofit hospital marketing techniques now include public seminars on how to market hospital laundry services. For example, among the seminars presented at the 47th Annual National Educational Conference for the National Association of Institutional Linen Management (NAILM), was one entitled, "How to Market Your Laundry's Services". Also provided at the seminar was a handout packet which included sample materials and examples of how to get started marketing in competition with commercial laundries.

In the February 15, 1987 edition of the American Laundry Digest, there is an article describing how the Rose Medical Center in Denver, Colorado, recently opened a new off-campus laundry to process not only its own linen but also provide service on a contract-basis to other Denver-area hospitals. The laundry was designed with excess space and equipment so that it could accomodate work for other hospitals, according to the hospital's head of support services.

III. OUTLOOK

All indications are that there will be continued pressure on nonprofit hospitals to generate outside revenue. Thus, these institutions will constantly try to compete unfairly with tax-paying for-profit corporations, especially in the textile maintenance market.

Changes in the corporate structure of nonprofit firms present yet another set of issues and concerns. Testimony given before the Select Committee to Study Nonprofits of the State of New York showed that some nonprofit firms - particularly hospitals - have carried the concept of using resources generally unavailable to nonprofit firms to a new and different level by creating new corporate structures in which the original nonprofit firm becomes only one of many corporate entities, both nonprofit and profit-making corporations. In essence, the hospital "spins off" its profit-making unrelated business activities to a "for-profit" corporation but uses its tax-exempt operation as a base to further its unfair competitive practices.

While no reliable data exists to determine the exact numbers, it is clear that a great number of hospitals have restructured their corporate identities. In response to third party payer legislation and other cost-cutting programs, hospitals saw corporate restructuring as a way to reduce operating costs.

A corporate structure that has been frequently used is one in which a nonprofit corporation becomes the parent corporation with the original hospital as either an affiliate or a subordinate nonprofit entity. In many cases, a for-profit entity is also created so that activities which are clearly outside the tax-exempt boundaries of the Internal Revenue Tax Code can be fragmented. With such a structure, hospitals can venture into nearly any area without risking the nonprofit status of the original entity.

Such a structure also allows a for-profit subsidiary of a nonprofit entity to channel profits back to the nonprofit parent. The nonprofit may draw down funds from the affiliate or subsidiary by charging administrative fees, receiving rental income from property or equipment, making loans and collecting interest, receiving dividends on stock of an affiliate/subsidiary, receiving charitable donations from the for-profit affiliate, or by receiving in-kind assistance from the for-profit.

Further, nonprofit and for-profit activities, such as a hospital laundry, of a parent/affiliate may be mixed at one location. In this situation, the lack of a method to "fragment" activities makes it impossible to arrive at a formula for property and other taxation.

IV. RECOMMENDATIONS

The Textile Rental Services Association of America believes in free competition and the free enterprise system. We do not believe that these institutions, built with federal funds and paying no taxes, should be allowed to continue to compete unfairly with the private sector. We do not believe that their activities, completely unrelated to patient care at their institutions, should be subsidized by federal, state or local funds.

The Textile Rental Services of America recommends the following:

- Non-profit hospitals should not be allowed to offer laundry services to any outside entity.
- Recognized accounting practices must be required for all existing non-profit corporations engaged in activities that generate unrelated business income.
- Not-for-profit hospital laundry groups must be required to pay their fair share of property and local taxes (i.e., state, county, city and local property and other taxes).

In conclusion, we are willing to compete fairly with anybody but we must vigorously object to a system which takes our hard earned tax dollars and uses it to fund a non-taxpaying competitor. Continuation of the existing situation will result in reduced revenue to our industry and reduced employment. We ask this committee to help us preserve our constitutional right to free and fair competition.

Chairman PICKLE. Thank you, Mr. Fellman, and I want to thank the panel for your brevity and for your specific recommendations. You have attempted to summarize your views and have done it well.

Mr. Fellman, let me ask you one question. You have said that your association has a list of some 80 hospitals which advertises openly to the public for business.

Mr. FELLMAN. Yes, sir.

Chairman PICKLE. Do we have a list of those?

Mr. FELLMAN. We will make that available to the staff.

Chairman PICKLE. I wish you would let our committee have that list.

Mr. FELLMAN. Yes, sir. Be glad to do it.

Chairman PICKLE. Now, Ms. Holm, you give a very graphic example of what has happened to your own business and though it is a small business, it may be typical throughout the land. Did the tax-exempt organizations come in and cut prices in offering services to the public?

Ms. HOLM. Yes, Mr. Chairman, they did. In Seattle, for example, Northwest Hospital will advertise a particular hearing aid for, say, $595. My price is $895. My price and the for-profit competitor's price are all within $10 to $20 of one another. Their prices are substantially lower.

Chairman PICKLE. Does the competition, as you term it, come from their cutting of prices or is it from the way they promote their services? Are the tax-exempt organizations taking vans and going out into the communities and openly soliciting business? Is that more damaging to your business or is it the lower prices?

Ms. HOLM. Absolutely.

Chairman PICKLE. Which?

Ms. HOLM. Pardon me, sir?

Chairman PICKLE. Absolutely which?

Ms. HOLM. Their capitalizing on the halo effect, their ability to go out and solicit donations from service clubs. They—Northwest Hospital currently has two $70,000 donated mobile vans. They go all over our community to such things as State fairs, the shopping malls, wherever the hearing impaired can be found.

Chairman PICKLE. Mr. Groome, you presented an example of hospitals actively engaging in the advertising of their laboratories, claiming that they openly advertised to doctors and other health facilities to solicit their business.

Mr. GROOME. Yes.

Chairman PICKLE. Apparently the IRS in a suit that was brought, or ruling issued, took the position that they were engaged in unrelated business.

Do you know in that particular instance or similar instances, whether the laboratory, or the hospital, paid UBIT?

Mr. GROOME. I don't know the answer to that question, Mr. Chairman.

Chairman PICKLE. Well, give our committee the specific instances where you say this is taking place. We would like to check to see if they paid the UBIT. Do you know?

Mr. GROOME. No, I don't know the answer.

Chairman **Pickle**. Now, Mr. Simmons, one comment to you. You have given us very good testimony and I can see how you feel about competition. I must say in some of the instances you make reference about the resale of either equipment or drugs. A lot of this really comes under the jurisdiction of the Robinson-Patman Act and is not part of UBIT. Whether you feel there is an exemption that should be there or not, the resale of a lot of these items, drugs and equipment, may really be a matter that more properly relates to the question of that act than to the UBIT.

Mr. **Simmons**. We think the two issues are inextricably intertwined. First of all, it is because of the UBIT and Federal and State laws that apply to nonprofits that they exist in the first place and the Robinson-Patman Act exemption was done at a time when hospitals were really basket cases, community hospitals were. They no longer are, and should no longer be able to do business this way. And this is one way to get at them.

Chairman **Pickle**. Do you have specific examples where a hospital has bought a particular type of equipment in large numbers and sold it to other hospitals or doctors?

Mr. **Simmons**. Yes, sir. We have many indications of that, some evidence, and we will give it to the staff.

[The following was subsequently received:]

The Health Industry Distributors Association has reviewed with committee staff a number of examples of direct mail solicitations and price lists from non-profit hospitals and their subsidiaries offering medical supplies for sale to physicians or other outside parties. These materials are not included in the record because it is voluminous and because, in some cases, the material has been obtained in confidentiality.

Chairman **Pickle**. I want facts where you claim this has taken place. Give us those examples specifically.

Mr. **Simmons**. Yes.

Chairman **Pickle**. Mr. Schulze.

Mr. **Schulze**. Thank you very much.

I would like to thank the panel for their testimony.

Mrs. Holm, it has come to my attention that a local Virginia hospital chain is attempting to take over a local hearing-aid supply business. Do you know anything about that?

Ms. **Holm**. No, I don't. But I am sure we would be able to include that in our testimony that we will be submitting and address that issue for you.

I do have our legal counsel with us. Perhaps he would have more information.

Mr. **Schulze**. Well, what does it cost one of your companies to purchase a hearing aid versus a nonprofit? You were saying that the costs, the selling price was $595 and $895. It seems to me that this is an area where high tech has made a great many advances. The prices have declined fairly dramatically.

Is this true in the hearing-aid business?

Ms. **Holm**. The purchase price that we pay the manufacturer has not declined. It has risen. I think where the nonprofits in my area at least are receiving an extremely better advantage is they are able to purchase in large, large quantities.

Mr. Mayer boasts of $80,000 inventory at one time. I can't possibly compete with that. The capitalization they have available is the difference.

Mr. SCHULZE. Isn't that true of the mom and pop hardware store versus the chain and everything else, the ability to buy in large quantity alone—are you saying the volume discounts are so great that you can't compete?

Tell me, are you prepared to tell me something about the costs and prices so I have a better idea of what we are talking about. What I am trying to determine is, whether the dollars count or whether the halo effect counts?

Ms. HOLM. The halo effect is much more important.

Mr. SCHULZE. I hear that is your opinion, but can you give me specifics? How much does it cost you to buy an average hearing aid from the distributor or manufacturer?

Ms. HOLM. It varies. I would say around $200.

Mr. SCHULZE. How much does it cost the competition, the nonprofit competition to buy that same product?

Ms. HOLM. Again I would have to say they receive a quantity discount and because they are buying in larger volumes, they would have a larger quantity discount. So I would have to guess it would be less but I don't know.

Mr. SCHULZE. Ms. Holm, I don't think that the manufacturer can offer to them anything they do not offer now.

Ms. HOLM. That is right.

Mr. SCHULZE. If you can't buy in that quantity, that is one thing, but if you are saying they won't give you the prices, then there is something else that is wrong. If we can't get prices, then I have to assume that somebody is trying not to let us have them.

I think it would be better if you either had some price sheets or something so that we could determine how much impact this is having.

Ms. HOLM. If I may respond, I believe that there is no discrimination between the manufacturers and ourselves and the nonprofits.

The point I tried to make earlier is that because they are nonprofits, their capitalization accounts far exceed mine. I think that if I had the same funds available, I would certainly have the same discounts. I am certain of that.

Mr. SCHULZE. So what we are getting down to is that the halo effect in your opinion is more important than the dollar differential. Do I read that correctly?

Ms. HOLM. Yes, sir.

Mr. SCHULZE. Okay. Thank you.

Mr. Simmons, you said that the hospitals were buying these things and I realize you represent the wholesalers, but you say they are buying them at 40 percent less than the wholesale cost.

Mr. SIMMONS. That is a function of——

Mr. SCHULZE. Tell me about that. Why can a hospital buy things 40 percent less than supposedly a volume wholesaler?

Mr. SIMMONS. It is a function of the Nonprofit Institutions Act exemption which may be a problem in the hearing-aid business, too. Robinson-Patman generally prohibits discrimination in price except for hospitals, nonprofits and anything that is a nonprofit. They are able to buy, regardless of volume, at deep discounts, much deeper than that available to wholesalers.

In many cases, our wholesalers have found it cheaper to buy goods through the hospital than it is to buy them through the manufacturer because they play on that difference. That is where the gray market comes from. It happens all the time. It is a fact of life and has been ever since the Nonprofit Institutions Act exemption was passed.

Mr. SCHULZE. It seems to me the manufacturer risks destroying any good will he has with the wholesale operation and makes himself subject to competition.

Mr. SIMMONS. Yes. That happens. There is a very complicated two-tier pricing out there in medical products where in many cases the goods are sold to the hospital at deep discount below dealer cost and the manufacturer will rebate to the dealer the difference, or most of it. It is a very complicated system. It is a bookkeeping nightmare and a dumb way to do business, but it is the way we do business.

Mr. SCHULZE. You are saying volume rebates play a large part. I realize there are bonuses and all kinds of pricing——

Mr. SIMMONS. This is not volume rebate; this is a rebate based on the exemption to the law. That is a key difference. You don't find this in any other industry.

Mr. SCHULZE. That is a standard process that they would have on printed price sheets or is that negotiable in each case?

Mr. SIMMONS. It is often negotiable, done through buying groups perhaps. The illegality comes in, and where the manufacturers and hospitals are exposed to legal action, is when they use that deep discount and then turn around and sell that good on the private market. They are supposed to buy it for their own use.

Mr. SCHULZE. Are the hospitals banding together as buying groups?

Mr. SIMMONS. Yes, that happens as it does in any industry and we can compete with that. But that is not what we compete with when an individual hospital takes advantage of the price it gets and sells it on the marketplace. That is illegal, but it is not enforced in many cases at all.

Mr. SCHULZE. Mr. Groome, you tell me about costs on laboratory tests. Are the costs about the same for a nonprofit and a for-profit laboratory to make a test or series of similar tests?

Mr. GROOME. It is impossible to determine because it would depend on the size of the laboratory that the hospital has and the size of the laboratory that it is competing with.

Mr. SCHULZE. So there is that problem. You have the size and degree of sophistication of the equipment which determines the cost?

Mr. GROOME. Degree and sophistication of equipment, the organization of the laboratory, to a great degree the test mix, the volume, services provided to the community, other elements impact cost of doing testing, such as quality control and many other factors.

Mr. SCHULZE. Overall, from the point of view of your organization, as more sophisticated equipment has become available for medical tests, have prices declined in relationship to those usage of new equipment?

Mr. GROOME. Prices have declined if you are talking about prices in the marketplace as opposed to costs within the laboratory, but not only because of technology but because of severe price-cutting competition throughout the industry. So it is difficult to say how much of that is due to new technology, automation of testing, et cetera.

Mr. SCHULZE. But in your opinion, the cost of laboratory tests have declined over the last decade or two?

Mr. GROOME. No, I would not say the cost of laboratory testing has declined. Some people——

Mr. SCHULZE. The cost to the consumer, the ultimate price of the test has not?

Mr. GROOME. Over the last decade? I can't answer that. It is relatively stable and has been for the last couple of years.

Mr. SCHULZE. Let me ask the panel whether their opinion that competition is more acute in rural areas or in urban areas? Whether that is not relevant or what?

Mr. SIMMONS. I would say in my particular area of interest, it is throughout the system. There is no real difference between—as a matter of fact, it may be worse in urban areas in the sense you have a heavier concentration of doctors in practice and therefore more customers available.

Mr. SCHULZE. Say the variety of services, laundries, laboratories, and so on, if you have a rural area where there is no laboratory, and if the hospital provides that as a service to the community, then it seems to me it is different than when you have an urban setting.

Mr. FELLMAN. In the laundry industry the problem exists in both rural and urban areas because we find we do have companies that service both rural and urban areas and no matter where we are, as soon as the local hospital finds it needs to generate funds and it has capacity in its laundry, out on the street it goes.

Mr. GROOME. The same is true of the laboratory industry. It is across the board, but the intensity of it is in the urban areas where there is a higher population concentration of physicians and hospitals.

Mr. SCHULZE. Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Schulze.

Mr. Flippo, do you have any questions?

Mr. FLIPPO. I pass, Mr. Chairman.

Chairman PICKLE. I want to ask the panel to specifically give us in writing your views on the proposal which Treasury has made in the first part of these hearings about possible changes or suggestions for changes. I am sure you are familiar with those. If not, please get a copy of the recommendations from the committee staff and respond to them, if you would.

[The following was subsequently received:]

Observations of the National Hearing Aid Society Regarding Seven Areas of Concern Identified by the Treasury Department in Its Testimony of June 22, 1987

1. While further detailed reporting about which activities are substantially related may be helpful, the relatedness test is general in nature and will continue to be difficult to apply. Tax-exempt organizations often engage in activities in which they have expertise and these activities quite often grow out of or are generally related to their exempt function activities. Thus, it will continue to be difficult for the Internal Revenue Service to determine the relatedness of these activities to the exempt function even with increased supervision.

   To assist in enforcement, we recommend that in addition to the substantially related requirement, there be a commerciality test. Wherever income is generated by regularly conducted activities of a commercial nature (which can be demonstrated by the existence of a for-profit competitor), such income should be presumed to be taxable. The tax-exempt organization can then rebut this presumption. By imposing a presumption of this type, it will be more difficult for a tax-exempt organization to engage in commercial activities under the guise of performing its exempt function.

2. If the relatedness test, however, is retained, we believe that the "convenience" exception should be eliminated, because this can easily be extended to unrelated activities.

3. We concur that stricter accounting principles, especially with reference to the allocation of expenses, should be required.

4. We agree that the definition of a controlled subsidiary be broadened to include those entities in which an exempt organization has more than a 50 percent interest in stock value or voting power, and would include the requirement that the definition would be satisfied where such stock ownership is held directly or indirectly (i.e., through one or more subsidiaries).

5. Regarding passive investment income of all tax-exempt organizations (including 501(c)(3) entities), we contend that it should be taxable, lest encouragement be given to using these resources to capitalize new commercial ventures or activities.

6. We agree that attention should be given to the definition of research and to requirements for public dissemination of the results of such research.

7. Because of the proliferation of imaginative, new corporate-structure or multi-layered organizations created by tax-exempt entities, where cross-subsidization is possible between for-profit and non-profit subsidiaries, as well as joint venture activities, we question whether the current statutory framework is adequate to prevent abuse. This becomes even more urgent where anti-competitive practices (including predatory pricing) can severely impact the survival of small business in a highly localized sense.

   Clearly, great attention should be given to these new or emerging corporate structures and relationships such as multi-layered corporations, joint ventures, partnerships and licensing agreements because of the potential for circumvention and abuse of the intention of the law.

Views of Paul Simmons, President, Health Industry Distributors Association, on recommendations of the U.S. Department of Treasury.

We agree with Donald Chapoton, that the administration of the "substantially related" test be improved through more detailed reporting and reevaluation of some of the existing exemptions. However, these steps are not sufficient to correct the abuses of non-profit status within the health care industry.

Non-profit hospitals competing with for-profit entities are, in most cases, carrying out their activities through for-profit subsidiaries. These use the advantages of tax-free capital, hospital-paid personnel, hospital property and, above all, their ability to purchase supplies at discriminatorily low rates under the Non-profit Institutions Act exemption to the Robinson-Patman Act.

The tax code should be revised to require that all for-profit activities of hospitals or other non-profit health care entities be strictly separated from their non-for-profit activities. The tax code should require a strict arms-length relationship. None of the accumulated capital through tax exemption should be invested in the for-profit activity. No hospital property or buildings should be used. No hospital employee should serve on the board of directors or be an executive or employee of the for-profit entity. All purchasing of supplies should be totally separated and resale of supplies be permitted only if supplies are purchased under the same terms available to the for-profit competitors of the non-profit entity.

Above all, the Robinson-Patman Act should be strictly enforced. Any activity which commingles the purchases, activities, or transactions of the non-profit entity with those of the for-profit subsidiary should invalidate the non-for-profit status of the parent organization, subjecting it to full taxation in all excess of income over expenses.

SUPPLEMENTAL STATEMENT

Of the American Clinical Laboratory Association
Concerning the Unrelated Business Income Tax
Before the Ways and Means Oversight Subcommittee

July 15, 1987

This supplemental statement is filed on behalf of the American Clinical Laboratory Association ("ACLA"), an organization of federally regulated, independent, tax-paying, clinical laboratories. ACLA testified before the Oversight Subcommittee at its UBIT hearings on June 26, 1987 and was asked to submit additional information. That information is contained herein.

I. Hospitals Engaged In Outreach Testing

First, ACLA was asked to supply a list of hospitals that it believes are engaging in "outreach testing," a term defined in our original testimony. In essence, outreach testing occurs when hospital laboratories provide testing services to physicians engaged in private practice. When conducted by tax-exempt hospitals, the revenues earned from such testing are taxable as unrelated business income pursuant to IRS Revenue Ruling 85-110, attached hereto as Appendix I. The requested list is included herewith as Appendix II.[1]

II. Issuance of Revenue Rulings 85-110 and 85-109

A second question asked by the Subcommittee involved the background underlying issuance by the IRS of Revenue Ruling 85-110. In the late 1970s, ACLA became concerned about the proliferation of outreach testing, particularly when conducted by tax-exempt hospitals. ACLA felt that the revenues earned by such hospitals from this type of testing should be taxable under the UBIT rules. Accordingly, ACLA petitioned the IRS to issue a revenue ruling declaring this revenue to be unrelated business income. In the fall of 1985, following the release of several private letter rulings on point and the decision of a federal district court in St. Luke's Hospital of Kansas City v. United States, 494 F. Supp. 85 (W.D. Mo. 1980), the Service issued the requested revenue ruling. As noted above, this ruling declared that for the most part outreach testing is subject to UBIT; it did, however, also enumerate a few limited circumstances, discussed below, when UBIT might not apply. It was issued in tandem with a related revenue ruling, 85-109, also included in Appendix II and discussed below, which rejected much of the holding in the St. Luke's Hospital case that outreach testing is related but which also recognized an exception to the taxability of outreach testing revenues derived from testing of tissue samples needed for "educational" purposes.

Despite the issuance of Rev. Rul 85-110, tax-exempt hospitals may still be engaging in unrelated outreach testing without declaring or paying tax on the income earned from this activity. ACLA is therefore gratified that the Subcommittee intends to determine whether the hospital identified in Appendix II are tax-exempt and whether they have properly completed and filed Forms 990 and 990-T.

1/ ACLA does not know whether all of the hospitals identified in Appendix II are tax-exempt nor does it know whether the outreach testing laboratory operated by the hospital is legally part of a tax-exempt entity or is separately organized as a for-profit subsidiary.

received. If the organization unilaterally determines that revenues should not be regarded as unrelated business income, then it is not obligated to disclose the fact that it has engaged in commercial activity -- activity which may have generated income subject to taxation under the Internal Revenue Code.

Line 78(c) of Form 990 does seek the following information from a reporting exempt organization:

> If the organization has gross sales or receipts from business activities not reported on Form 990-T, attach a statement explaining your reason for not reporting them on Form 990-T.

While line 78(c) is a step in the right direction, it does not go far enough and, in the absence of appropriate instructions, is subject to varying interpretations. The Form 990 reporting requirements should be clarified to ensure complete disclosure of any commercial activity engaged in by the tax exempt organization.

Specifically, lines 78(a) through (c) of Form 990 should be deleted and replaced by the following language:

> 78(a) Did the organization engage in any commercial activity during the year covered by this return?
>
> (b) If yes, attach a statement describing the nature and extent of such commercial activity and indicating the amount of revenues derived from this activity.
>
> (c) Did the organization file a tax return on Form 990-T, exempt organization business income tax return, for this year?

To clarify the type of information sought by the above questions, the following language should be included in the specific instructions that accompany the Form 990:

> Line 78. Indicate whether the organization has engaged in any commercial activity. For this purpose, "commercial activity" includes any activity undertaken by the organization which is in competition with private, for-profit organizations. For example, a tax exempt hospital, which performs laboratory services for non-hospital patients in competition with commercial clinical laboratories or which sells pharmaceuticals in competition with commercial pharmacies, would be engaged in "commercial activity" and is required to indicate this fact on the form. The nature and extent of such commercial activities should be also be described in detail. In addition to stating the amount of revenues derived from this activity, the description should include, for example, the following information: services offered by the organization in connection with the activity, geographic area serviced by the activity, and any marketing techniques utilized by the organization relating to the activity. The organization should also indicate whether it has filed a form 990-T.

Inclusion of the above language in the Form 990 and in the accompanying instructions would help the IRS identify exempt organizations that are generating taxable income from commercial activity. While ACLA is primarily concerned with the outreach testing activities of tax-exempt hospitals, the affirmative disclosure requirement which it seeks to have included in the Form 990 is equally relevant with respect to other tax-exempt organizations and would generally facilitate more effective enforcement of the requirements of the Internal Revenue Code.

B. Reexamination of Exemptions

The second recommendation made by the Department of Treasury is "that the scope of the exemptions for businesses operated by volunteers or for the convenience of students, patients and others ... be reexamined." ACLA, like Treasury, is "concerned that these provisions may extend to activities not meriting exemption and, at least in their current form, cannot be justified on grounds of administrative convenience."

In Rev. Rul. 85-109, included herewith as part of Appendix I, the IRS examined the extent to which it would follow the decision in St. Luke's Hospital of Kansas City v. United States, supra, attached hereto in Appendix III. That case held that a tax-exempt hospital's performance of diagnostic laboratory testing upon the specimens of patients of the hospital's staff physicians was not unrelated trade or business because: (1) the hospital needed the specimens to carry out its educational activities; and (2) the hospital staff physicians were "members" of the hospital and the testing was performed by the hospital primarily for the convenience of those members. In Rev. Rul. 85-109, the IRS responded to this two-pronged holding:

> It is the position of the Service that the hospital's staff physicians are neither 'members' nor 'employees' of the hospital in their capacities as private practitioners of medicine. By providing laboratory testing services on tissue specimens referred by its staff physicians in their private capacities, the hospital is not carrying on an activity primarily for the convenience of its members, officers, or employees within the meaning of Section 513(a)(2) of the Code.
>
> However, because the facts show that the services provide a supply of specimens needed in the hospital's teaching program, they are substantially related to the exempt purposes of the hospital.

Accordingly, the Service decided that it would follow that portion of the St. Luke's Hospital decision that holds that a teaching hospital that conducts non-patient laboratory testing on specimens needed for its teaching activities is not engaged in unrelated trade or business, so long as the outside testing services contribute importantly and substantially to the hospital's teaching program. ACLA believes that this aspect of both Rev. Rul. 85-109 and the St. Luke's Hospital decision is incorrect.

Hospitals need not engage in outreach testing to obtain a sufficient supply of specimens to perform their teaching function. In general, adequate numbers and types of specimens can be derived from the hospital's own patients. Indeed, many teaching hospitals function without outreach testing as a source for specimens. Others, that have recently instituted outreach programs, operated for years without such programs and were able to obtain from in-house the specimens needed for teaching. Finally, if specific, esoteric specimens are needed, they can be borrowed. In short, a teaching hospital does not have to compete in a tax-exempt fashion with tax paying laboratories to obtain specimens with which to teach.

C. Competition of Tax and Allocation of Expenses

The third set of Treasury recommendations relate to the computation of tax on unrelated business income and the rules for allocation of expenses. As an initial matter, ACLA opposes an increase from $1,000 to $5,000 of the specific deduction from unrelated business income. ACLA does agree that the rules should be clarified to reflect the appropriate relationship between an organization's exempt functions and its unrelated activities. Thus, with regard to the proper allocation of expenses between related and unrelated laboratory testing (i.e., that performed for the hospital's own patients as opposed to that performed for the private patients of physicians), the only expenses that should be deductible against unrelated business income derived from outreach testing are those expenses that are incurred for the incremental direct operating costs of the outreach activity.

The laboratory testing facilities and personnel employed by hospitals are primarily and substantially used to conduct their tax-exempt purpose, i.e., the provision of health care to hospital patients. To allocate any portion of those expenses to outreach activities would unfairly reduce UBIT as the hospital would have to employ these facilities and personnel even if it were not engaged in the outreach market. Indeed, many hospitals justify their involvement in outreach testing as a method for making use of excess capacity. Generally a hospital does not have to employ additional personnel or obtain increased plant or equipment to enter into or continue in the outreach testing market. It simply uses existing capacity. In this situation, the only incremental direct operating expense attributable to outreach testing is the cost of purchasing the laboratory supplies for the performance of the testing. As a result, the hospital enjoys a substantial profit from this activity. Tax-exempt hospital laboratories that are offering such testing and enjoying such profits should pay tax on them, and they should be taxed at standard corporate rates. Thus, ACLA disagrees with both the decision in Renssalaer Polytechnic Institute v. Commissioner, 732 F.2d 1058 (2d Cir. 1984), and the methodology for cost allocation offered by the Department of Treasury in its testimony.

D. Broadened Definition of Controlled Subsidiary

The fourth Treasury recommendation is that the "definition of a controlled subsidiary be broadened to include subsidiaries in which an exempt organization has more than a 50% interest in stock value or voting power. In addition, for purposes of determining whether the primary purpose of an organization is the conduct of an exempt function, we suggest that consideration be given to aggregating the activities with the exempt organization's subsidiaries in appropriate cases." ACLA agrees with this recommendation. In recent years, numerous hospitals have reorganized into various for-profit and non-profit entities. Among the tax paying subsidiaries that have been created are laboratories, developed, at least in part, to offer outreach testing. Typically, these tax paying laboratories are owned in whole or in part by a tax-exempt hospital-related parent.

To the extent that the tax-paying subsidiary makes certain payments to the tax-exempt hospital, such payments reduce the subsidiary's taxable income; moreover, certain of these payments are not taxed to the parent under UBIT because of the specific exclusions for interest, rent, anuities, or royalties. Thus, for example, the for-profit laboratory may pay the parent hospital organization rent for the use of the laboratory space, as well as interest on money loaned to the subsidiary by the parent, without any tax consequences for the parent and with substantial tax benefits for the subsidiary.

ACLA agrees with the Department of Treasury that the present law does not deal adequately with controlled subsidiaries.

Accordingly, the Treasury recommendations should be seriously considered.

ACLA also agrees with Treasury's concerns about the creation of for-profit subsidiaries to avoid the primary purpose test. As Treasury suggests, "consideration should be given to a rule that in appropriate cases aggregates the activities of an exempt organization and its subsidiaries," particularly given the restructuring of numerous hospitals and the creation of for-profit subsidiaries that, among other things, provide laboratory testing services.

E. Taxability of Passive Income

The Department of Treasury is also concerned about the tax treatment of passive income. ACLA agrees with Treasury that the treatment of passive income and the exceptions that this type of income is afforded should not be allowed to permit organizations to avoid tax liability on activities that UBIT is intended to reach. Therefore, consideration should be given to narrowing some of the exceptions in this area.

F. Income Derived From Research

The sixth recommendation offered by the Department of Treasury relates to income derived from certain research activities. The Department believes that "additional attention should be given to the definition of research and to requirements for public dissemination of the results of research." ACLA agrees. Tax exemption may not be appropriate for research activities that may be conducted in the private sector and for which sufficient public benefits will not be available. Moreover, where research results in truly commercial activities, such research does not merit tax exemption.

G. Joint Ventures Between Tax-Exempt Organizations and For-Profit Entities

Finally, the Department of Treasury is concerned about the joint venture activities of exempt organizations. The Department states that the "current restrictions on partnership allocations between taxable and tax exempt partners may not be adequate to prevent abuse." Treasury also questions whether "current law is adequate to deal with issues raised by partnerships formed to conduct exempt activities of tax exempt organizations." ACLA shares the Department's concerns. The use of joint ventures by hospitals for the performance of various business activities has grown significantly in recent years. Although Treasury reports that hospitals have become members of partnerships involving the construction of medical office buildings or the acquisition of CT scanners, the use of this legal vehicle extends far beyond these two illustrations. For example, some hospitals have begun to offer partnership interests in the hospital laboratory to test-referring physicians. This mechanism creates opportunities for the shifting of tax benefits. Thus, ACLA agrees with Treasury that consideration be given to imposing additional restrictions on allocations between taxable and tax-exempt partners to prevent the shifting of deductions from exempt to taxable partners. ACLA further agrees that it would be appropriate to subject to UBIT the income earned by an exempt organization from a partnership with a taxable partner for the performance of an exempt activity.

V. Summary

In conclusion, ACLA urges enhanced enforcement of UBIT. Hospitals are increasingly entering the outreach arena, competing in a tax-favored manner with commercial laboratories and depriving the Treasury of needed tax revenues. The extent of this activity is illustrated both in the list attached hereto as Appendix II and in documents included as Appendix IV which are illustrative of the practice. As a result, the Subcommittee should consider the recommendations contained in ACLA's initial testimony, as well as those offered by the Department of Treasury. In the simplest terms, ACLA seeks a regulatory environment in which hospital and independent laboratories compete on an equal footing without direct or indirect subsidy to one category of competitor at the expense of another. We thank the Subcommittee for providing us with the opportunity to submit this supplemental statement.

Law Offices
Loomis, Owen, Fellman & Howe
2020 K Street, N.W.
Washington, D.C. 20006
—
202 296-5680

Stephen F. Owen, Jr.
Steven John Fellman
William H. Howe
James E. Anderson
Richard A. Steyer
John J. Kelly
Richard B. Fellows, Jr.
Dianne V. Keller
Elizabeth M. Powell

John E. Loomis
1921-1984

Elmer F. Bennett
Counsel

RECEIVED
JUL 8 1987
Ways and Means
Subcommittee on Oversight

July 2, 1987

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, DC 20515

Dear Chairman Pickle:

Thank you for the opportunity to testify before your committee on June 26.

As you requested, we are sending you a list of hospitals that are soliciting laundry business.

The Textile Rental Services of America appreciates your interest in this problem and we would be glad to provide any additional information that you request.

Sincerely,

LOOMIS, OWEN, FELLMAN, & HOWE

Steven John Fellman

SJF:jl
Enclosure

cc: Beth Vance

NONPROFIT HOSPITALS SOLICITING LAUNDRY BUSINESS

1. Oneida City Hospital
   Oneida, NY

2. Saint John's Regional Health Center
   Aurora, MO

3. Presbyterian Hospital
   Charlotte, NC

4. York Hospital
   York, PA

5. Saint Peter's Medical Center
   New Brunswick, NJ

6. The University Health Center
   Pittsburgh, PA

7. Saint John's Regional Health Center
   Springfield, MO

8. Saint John's Hospital
   Rochester, NY

9. Chestnut Hill Hospital
   Rochester, NY

10. Binghamton Hospital
    Binghamton, NY

11. Methodist Hospital
    Memphis, TN

12. Saint Luke's Hospital
    Kansas City, MO

13. Charter Hospital
    Overland Park, MO

14. Hospital Linen Services of Kansas
    Kansas City, MO

15. Beaver Dam Community Hospital
    Beaver Dam, WI

16. Madison United Hospital Laundry
    Madison, WI

NONPROFIT HOSPITALS SOLICITING LAUNDRY BUSINESS
PAGE 2

17. Kuakini Medical Center
Honolulu, HI

18. Queens Medical Center
Honolulu, HI

19. Salem Hospital
Salem, OR

20. Oregon Penitentiary
Salem, OR

21. Buffalo General Hospital
100 High Street
Buffalo, NY 14203

22. Mt. Saint Mary's Hospital
5300 Military Road
Lewiston, NY 14092

23. Mercy Hospital
565 Abbott Road
Buffalo, NY 14220

24. Woodville State Hospital
Carnegie, PA 15106

25. Presbyterian Hospital
200 Hawthorne Lane
P.O. Box 33549
Charlotte, NC 28233

26. Cleveland Memorial Hospital
201 Grover Street
Shelby, NC 28150

27. Charles A. Cannon Jr. Hospital
P.O. Box 8
Banner Elk, NC 28604

28. Forsyth County Hospital Authority
3333 Silas Creek Pkwy
Winston-Salem, NC 27103

29. Greenville Hospital System
701 Grove Road
Greenville, SC 29605

NONPROFIT HOSPITALS SOLICITING LAUNDRY BUSINESS
PAGE 3

30. Spartanburg General Hospital
101 East Wood Street
Spartanburg, SC 29303

31. Winchester Medical Center
South Stewart Street
Winchester, VA 22601

32. Washington Hospital Center
110 Irving Street
Washington, DC 20010

33. Sibley Memorial Hospital
5255 Loughboro Road
Washington, DC 20016

3/19/87

HOSPITALS SELLING/PURCHASING SERVICES

Hospitals Selling Service

Augustana Hospital
4[illegible]1 W. Dickens
Chicago, IL 60614
(312) 975-5000 330 Beds

Holy Cross Hospital
2701 W. 68th Street
Chicago, IL 60629
(312) 471-8000 425 Beds

Mount Sinai Hospital
15th and California
Chicago, IL 60608
(312) 542-2000 438 Beds

Rush Presbyterian-St. Lukes Hospital
1[illegible] W. Congress
Chicago, IL 60612
(312) 942-7000 1205 Beds
(charges 23¢/lb.)

Saint Anne's Hospital
4[illegible] W. Thomas
Chicago, IL 60651
(312) 378-7100 390 Beds

South Chicago Hospital
232[illegible] E. 93rd St.
Chicago, IL 60617
(312) 978-2000 413 Beds
(charges 18 3/4¢/lb.)

City of Hope Hospital
1500 E. Duarte Rd.
Duarte, CA 91010
(818) 359-8111 212 Beds

Hospitals Purchasing Service

Chicago Lakeshore Hospital
4840 N. Marine Drive
Chicago, IL 60640
(312) 878-9700 104 Beds

Loretto Hospital
645 S. Central
Chicago, IL 60644
(312) 626-4300 186 Beds

Schwab Rehab Hospital
1401 S. California
Chicago, IL 60608
(312) 522-2010 53 Beds

LaGrange Memorial
5101 Willow Springs Rd.
LaGrange, IL 60525
(312) 352-1200 276 Beds

Forest Hospital
555 Wilson
Des Plaines, IL 60616
(312) 635-4100 200 Beds

Jackson Park Hospital
7531 S. Stony Island
Chicago, IL 60649
(312) 947-7500 260 Beds

?

3/19/87

Hospitals Selling Service	Hospitals Purchasing Service
Glendale Adventist Medical Center 1509 Wilson Terr. Glendale, CA 91206 (818) 240-8000 452 Beds	?
Huntington Memorial Hospital 100 Congress St. Pasadena, CA 91105 (818) 440-5000 513 Beds	Verdugo Hills Hospital 1812 Verdugo Blvd. Glendale, CA 91208 (818) 790-7100 150 Beds
Dominican Santa Cruz Hospital 1555 Soquel Dr. Santa Cruz, CA 95065 (408) 476-0220 152 Beds	?
Lodi Memorial Hosptial 975 S. Fairmont Ave. Lodi, CA 95249 (209) 334-3411 99 Beds	Mark Twain Hospital 768 Mountain Ranch Rd. San Andreas, CA 95249 (209) 754-3521 49 Beds Amador Hospital 810 Court St. Jackson, CA 95642 (209) 223-1120 87 Beds
Mesquite Physicians Hospital 1527 N. Galloway Mesquite, TX 75149 (214) 285-6391 132 Beds	Humana Hospital Garland (formerly Garland Comm. Hosp.) 122 S. Intl. Garland, TX 75042 (214) 276-9511 192 Beds Shiloh Park Hospital (formerly Med. Ctr. Hosp.) 2010 S. Shilo Rd. Garland, TX 75041 (214) 271-9521 40 Beds General Hospital of Lakewood 1600 Abrams Rd. Dallas, TX 75214 (214) 824-4541 66 Beds
Buffalo General Hospital 100 High Street Buffalo, NY 14203 (716) 845-5600 1043 Beds	Buffalo Columbus Hospital 300 Niagra Street Buffalo, NY 14201 (716) 845-4300 93 Beds

3/19/87

Hospitals Selling Service		Hospitals Purchasing Service	
Huron Road Hospital 18101 Lorain Avenue Cleveland, OH 44111 (216) 761-3300	387 Beds	Hillcrest Hospital 6780 Mayfield Rd. Mayfield Heights, OH 44124 (216) 449-4500	305 Beds

NOTE: Hillcrest discontinued service from AHSG 1/1/86. Hospital service did not measure up. AHSG regained account January 3, 1987.

Hospitals Selling Service		Hospitals Purchasing Service	
St. Vincent Charity Hosp. & Health Ctr. 2351 E. 22nd Street Cleveland, OH 44115 (216) 861-6200	442 Beds	Grace Hospital 2307 W. 14th St. Cleveland, OH 44113 (216) 687-1500	87 Beds
		St. John Hospital 7911 Detroit Ave. Cleveland, OH 44102 (216) 651-7000	203 Beds
St. Joseph Hospital 205 W. 20th St. Lorain, OH 44052 (216) 245-6851	356 Beds	Elyria Memorial Hosptal 630 E. River St. Elyria, OH 44035 (216) 323-3221	359 Beds
Shared Hospital Ser. Nashville, TN		Jesse Holman Jones Hosp. Brown Street Springfield, TN 37172 (615) 384-2411	101 Beds
University Hospital 1350 Walton Way Augusta, GA 30910 (404) 722-9011	762 Beds	Edgefield County Hospital Bausket St., Box 590 Edgefield, SC 29824 (803) 637-3174	40 Beds
Holston Valley Hosp. & Med. Ctr. W. Ravine St., Box 238 Kingsport, TN 37662 (615) 246-3322 (Bid put in - not serving yet)	502 Beds	Indian Path Hosptal 2000 Brookside Rd. Kingsport, TN 37660 (615) 246-4311	300 Beds
Huntsville Hospital 101 Sivley Rd. Huntsville, AL 35801 (205) 533-8020 (Putting in bids in a lot of other places)	526 Beds	Jackson County Hospital Woods Cove Rd., Box 927 Scottsboro, AL 35768 (205) 259-4444	168 Beds

3/19/87

Hospitals Selling Service	Hospitals Purchasing Service
Ft. Sanders Regional Med. Ctr. 1901 Clench Ave., S.W. Knoxville, TN 37916 (615) 546-2811 560 Beds	Sevier Medical Center Middle Creek Rd. Sevierville, TN 37862 (615) 453-7111 133 Beds (satellite hosp. of Ft. Sanders)
Hospital Services Columbia, SC (ownded by member hosp.)	Providence Hospital 2435 Forest Dr. Columbia, SC 29204 (803) 256-5300 214 Beds Richland Mem. Hospital 3301 Harden St. Columbia, SC 29203 (803) 765-7011 602 Beds Lexington County Hospital 2720 Sunset Blvd. West Columbia, SC 29169 (803) 791-2000 270 Beds
Health Southeast Inc. Lawrenceville, GA (Shared service)	Gwinnett Hosp. System (formerly Button-Gwinnett Hosp.) 255 Scenic Hwy. S.W., Box 348 Lawrenceville, GA 30245 (404) 963-6101 242 Beds Northeast Georgia Medical Center 743 Spring St. N.E. Gainesville, GA 30505 (404) 535-3553 308 Beds
St. Rita's Medical Center 730 W. Market St. Lima, OH 45801 (419) 227-3361 405 Beds	Mary Rutan Hospital 205 Palmer Ave. Bellefontaine, OH 43311 (513) 592-4015 114 Beds
Martin's Ferry Hospital 90 N. Fourth St. Martins Ferry, OH 43935 (614) 633-1100 236 Beds	St. John Medical Center St. John Hts. Steubenville, OH 43952 (614)264-8000 234 Beds

3/19/87

Hospital Selling Service	Hospitals Purchasing Service
Wooster Comm. Hosp. 1761 Beall Ave. Wooster, OH 44691 (216) 264-4112 169 Beds	Joel Pomerine Mem. Hosp. 500 Wooster Rd. Millersburg, OH 44654 (216) 674-1015 53 Beds Kettering Hospital 546 N. Union St. Loudonville, OH 44842 (419) 994-4121 23 Beds
Trumbull Mem. Hospital 1350 E. Market Warren, OH 44482 (216) 841-9011 476 Beds	Hillside Hospital 8747 Squires Lane, N.E. Warren, OH 44484 (216) 841-3700 109 Beds
Fairview General Hospital 18101 Lorain Ave. Cleveland, OH 44111 (216) 476-7000 475 Beds	Lutheran Med. Center 2609 Franklin Blvd. Cleveland, OH 44113 (216) 696-4300 212 Beds
Lake County Memorial Hosp. Washington at Liberty Painesville, OH 44077 (216) 354-2400 326 Beds	Ridgecliff Hospital 35900 Euclid Ave. Willoughby, OH 44094 (216) 951-1177 160 Beds
St. Joseph HOspital 205 W. 20th Lorain, OH 44052 (216) 245-6851 356 Beds	Elyria Mem. Hospital 630 E. River St. Elyria, OH 44035 (216) 323-3221 359 Beds
Reid Mem. Hospital 1401 Chester Blvd. Richmond, IN 47374 (317) 983-3000 385 Beds	Wayne Hospital 835 Sweitzer St. Greenville, OH 45331 (513) 548-1141 97 Beds
St. Vincent Charity Hosp. & Health Ctr. 2351 E. 22nd St. Cleveland, OH 44115 (216) 861-6200 442 Beds	St. John Hospital 7911 Detroit Ave. Cleveland, OH 44102 (216) 651-7000 203 Beds Grace Hospital 2307 W. 14th St. Cleveland, OH 44113 (216) 687-1500 87 Beds

3/19/87

Hospitals Selling Service		Hospitals Purchasing Service	
Lima Rehab Lima, OH		Lima State Hospital 2350 North W. St. Lima, OH 45801 (419) 227-3361	405 Beds
St. Joseph Mercy Hospital 900 Woodward Ave. Pontiac, MI 48053 (313) 858-3000	531 Beds	Mount Carmel Mercy Hosptal 6071 West Outer Rd. Detroit, MI 48235 (313) 927-7000	597 Beds
Emma L. Bixby Hospital 818 Riverside Ave. Adrian, MI 49221 (517) 263-0711	212 Beds	Morenci Area Hospital Sims Hwy. Morenci, MI 49256 (517) 458-2236	33 Beds
Metropolitan Hospital and Health Ctr. 1800 Tuxedo Ave. Detroit, MI 48206 (313) 252-1000	157 Beds	Wyandotte General Hosptial 2233 Biddle Ave. Wyandotte, MI 48192 (313) 284-2400	383 Beds
Port Huron Hospital 1001 Kearney St. Port Huron, MI 48060 (313) 987-5000	252 Beds	St. Clair City Medical 8332 County Park Dr. Goodells, MI 48027 (313) 325-1291	75 Beds

Law Offices

Loomis, Owen, Fellman & Howe

2020 K Street, N.W.
Washington, D.C. 20006

202 296-5680

Stephen F. Owen, Jr.
Steven John Fellman
William H. Howe
James E. Anderson
Richard A. Steyer
John J. Kelly
Diann V. Keller
Elizabeth M. Powell
Andrew J. Kamerer

John E. Loomis
1921-1980

Elmer F. Bennett
Counsel

July 14, 1987

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Chairman Pickle:

On behalf of the Textile Rental Services Association, we thank you for the opportunity to testify before your committee on June 26, 1987.

As you requested, we are sending you our comments on the Treasury Department proposal concerning the Unrelated Business Income Tax (UBIT).

The Textile Rental Services of America appreciates your interest in this problem and we would be glad to provide any additional information that you request.

Sincerely,

LOOMIS, OWEN, FELLMAN, & HOWE

Steven John Fellman

SJF:jl
Enclosure

cc: Beth Vance
TRSA

Unrelated Business Income Taxation

Treasury Department Proposals

Comments by the Textile Rental Services Association of America

July 14, 1987

The Textile Rental Services Association of America is the nation's leading textile rental industry association. TRSA represents over 1,400 companies who rent and launder textile items to millions of customers in commerce, industry and the professions. TRSA member companies have sales of over $5.2 billion and employ more than 110,000 people.

The following are our comments on proposals by the Treasury Department dealing with the problem of income-producing activity by tax-exempt organizations.

A NONPROFIT HOSPITAL SHOULD NOT OPERATE A COMMERCIAL LAUNDRY

Our concern, specifically, is with nonprofit hospital laundry operations competing unfairly in the commercial market with TRSA's tax-paying members. TRSA's basic position is that nonprofit hospitals should not be allowed to offer laundry services to any outside entity.

The rationale behind tax exemption is stretched to the breaking point when nonprofit hospitals are permitted commercial laundry operations. One of the reasons hospitals are granted tax-exempt status is because they fulfill a public role in providing health services. However, when that activity moves into the area of commercial laundry operation, the mission and basic purpose of the hospital is clearly violated. As one TRSA member commented:

> "They do this under the mantle of trying to hold down medical costs. Well then where does it stop? What about air taxi service, janitorial service, restaurants, and everything under the sun, as businesses for them to enter in order to hold down medical costs. I would suggest that it be confined to the premises of the hospital. That seems to be a natural boundary."

COMMENTS ON TREASURY PROPOSALS

If a ban on commercial laundry operations by nonprofit hospitals is not possible, TRSA makes the following comments on each of the Treasury Department proposals:

1) Retain the "substantial relationship" test to determine a nonprofit's related/unrelated business income, with more detailed reporting to improve enforcement and compliance.

Our comment: Support it. Most hospitals admit laundry business is a sideline unrelated to health care. However, the test should be retained, and possibly strengthened, to make sure that a commercial laundry operation cannot be related to a hospital's health care purpose.

2) Reexamine (and possibly reduce) the variety of exemptions now available for unrelated business operated by volunteers or for the convenience of customers.

Our comment: Support it.Hospital laundry operations servicing only in-house needs often do not even pay for themselves. This is particularly true when, as is the case presently, the capacity is under utilized due to shorter and less frequent hospital stays by patients. An outside contractor frequently can do the job more economically.

3) (a) Restrict allocation of expenses that offset UBIT.
   (b) Retain the "fragmentation rule."
   (c) Increase the specific deduction from $1,000 to $5,000.

Our comments:

Support (a). This is one of the more serious problems faced by TRSA members: the misallocation of expenses by a hospital to its laundry operation. Hospital laundry operations offer huge discounts - often in the 50% range - that would not be commercially possible if all costs were correctly taken into account. Although the Internal Revenue Code requires that the unrelated business income of a nonprofit hospital laundry be subject to taxation, in-house accounting systems used by nonprofit hospitals allocate a disproportionate amount of overhead costs such as energy (water and sewage), utilities, space, costs of supplies and equipment, administration, and depreciation to laundry operation. As a result, for tax purposes, most of these hospital laundries claim that they operate on a break-even basis and therefore, do not have to pay tax.

TRSA supports Treasury proposals directed at the problem. Endorsement is given to specific proposals reducing the amount of fixed costs allocable between commerical and exempt use, and a limitation on deductible expenses to fair market value of the goods or services provided.

Support (b). This has a marginal effect on our members, but the "fragmentation rule" would help keep in-house and commercial laundry operations distinct.

Oppose (c). This also has a marginal effect on our members. However, even the present $1,000 exemption has a serious effect on a small businessman in the way of lost profits.

4) (a) Tighten up definition of "controlled subsidiary."
   (b) Include activities of subsidiary as part of activity of parent in determining whether primary purpose of the organization is an exempt function.

Our comments:

Support (a). This also ranks as one of the more serious problems facing commercial laundry operators. One way nonprofits escape UBIT is to create business subsidiaries. The subsidiary pays to the exempt parent nontaxable payments such as rent, interest on loans, or royalties. The subsidiary reduces its tax liability by deducting those payments from its gross income. Commercial laundry operators have noted the abuse as one of our members wrote:

> "I am aware of recent court rulings to the effect that hospital "co-op" laundries cannot be tax-exempt. But the dodge that the hospitals have come up with to get around that ruling is so transparent that it makes the law look ridiculous. All they have done is to set up subsidiaries or related companies which are "for profit" to operate the laundries. The "for profit" subsidiary files a tax return and complies with the law. But they still pay very little to no tax because it turns out that the "for profit" subsidiary doesn't make any profit. They don't make a profit because they adjust the prices they charge to their own hospitals such that the "for profit" subsidiary just breaks even."

TRSA supports Treasury proposals to restrict the definition of a "controlled" subsidiary by a more realistic test of 50% interest measured in stock value or voting power. Also endorsed are ownership attribution rules.

Support (b). The primary purpose of an exempt organization comes into doubt when its unrelated business activity begins to overshadow its exempt activity. An exempt organization can bypass this rule by putting the unrelated business activity into a separate subsidiary. Treasury proposes that in determining an exempt organization's primary purpose consideration should also be given to the activities of its subsidiaries.

Enclosed is an article on the opening of a new $2 million commercial laundry by the Rose Medical Center in Denver, Colorado. It is uncertain whether the laundry operation is a formal Medical Center subsidiary or a department. Nevertheless it is indicative of the degree to which nonprofit hospitals have gotten into the business. TRSA supports the Treasury proposals for determining primary purpose.

5) Begin to tax passive income.

Our comment: Not applicable.

6) Begin to tax research income.

Our comment: Not applicable.

7) Deal with abuse in partnerships avoiding taxes.

Our comment: Support it. Partnership arrangements can be abused in setting up laundry operations.

Any other proposals which are directed at the problem of commercial laundry operations by nonprofit hospitals are supported by TRSA.

We are available to help in developing more specific proposals.

At ceremony opening the new laundry are (l. to r.): Joel Edelman, president of Rose; Mack McKay, director, materials management; Joe LaNier, vp, support services; Ed Glick, chairman, Rose Foundation, and Jeffrey Dorsey, administrator.

High Tech in Denver

Rose Medical Center in Denver, Colo., recently opened a new off-campus laundry, called the Rose Institutional Laundry, to process not only its own linen but also provide NOG service on a contract-basis to other Denver-area hospitals.

The laundry is located in a leased warehouse 4½ miles from the hospital and also includes space for the hospital's entire materials management department. Equipment and building renovation cost about $2 million, excluding tap fees.

The laundry, which is capable of doing 8 million pounds of linen per year with one shift, has two 8-module continuous batch washers, utilizes thermal fluid for its ironers and for steam for several presses, and has a direct-fired water heater to provide for its hot water needs.

"It was designed with excess space and equipment so we can do work for other hospitals," according to Joe LaNier, vp of support services at Rose. "But it didn't cost a whole lot more than it would have just for us."

Equipment costs were $1.2 million, and building renovation totaled about $800,000. Tap fees, sewer fees and other money to bring the building up to code were about $140,000, LaNier said.

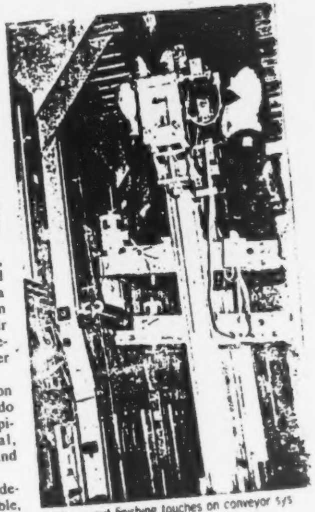
He estimated that $300,000 could have been knocked off the cost if the laundry had been built only for Rose which processes about 2 million pounds of linen per year. That would have included $260,000 for a second eight-module tunnel washer and dryers.

"We needed a back-up, anyway, but the main reason we chose to add the additional equipment is because a need exists in the Denver metropolitan area for other hospitals to get their work done at a facility designed specifically for hospital work," LaNier said.

Even before the laundry started on Aug. 1, it had already contracted to do the linen for three other Denver hospitals—National Jewish Hospital, Mount Airy Psychiatric Center, and Rocky Mountain Hospital.

Because the laundry has been designed to be as labor free as possible, LaNier said Rose feels that it can offer the NOG service at a per pound dryweight in the low 20¢ range and with no surcharges, although the rate will vary somewhat. According to the contracts, the laundry will offer one delivery per day five days a week and one pickup six days a week on a dock-to-dock basis. Each client-hospital will need its own residual staff for in-house collection and delivery.

Although the three contract hospitals have a combined volume of only 500,000 lbs. of linen per year, Mack McKay, director of materials management, said seven other Denver-area hospitals with 13 million pounds of linen annually have been targeted as potential customers.



Workmen put finishing touches on conveyor system that carries batches from the washers.

"We feel we can save them money, offer a quality product, and at the same time, make a slight profit for ourselves and keep our equipment busy," McKay said.

Eli Osatinski, president of Systems Design International, Inc., Englewood, Colo., which served as laundry consultant on the project, agreed. "Hospitals can no longer look at the laundry as a service," he said. "They have to look at it as a business. If they

Joe LaNier and others check progress as first loads pass through the new plant.

want to make a living with it, then the more they wash, the cheaper it gets."

The laundry was designed specifically to handle "acute general" hospitals. The tunnel washers go through barrier walls that separate the soiled and clean sections of the laundry and an exhaust system which provides negative air pressure takes contaminated air out of the soiled side of the building.

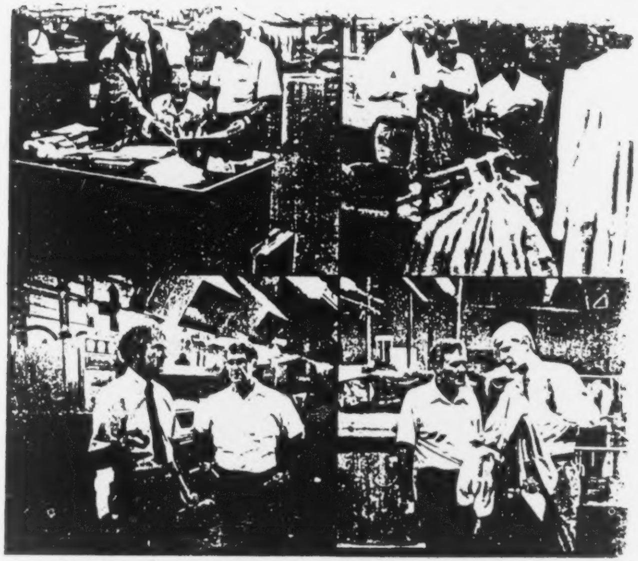
Even a small wash room and drycleaning section off the finishing department has a ceiling and walls so that there is no cross-contamination. "Not many hospital laundries have drycleaning," McKay said. "But we wanted to be able to dryclean hospital curtains and cubicle curtains. One of our problems used to be that some of our curtains were ruined in commercial laundries."

The laundry is set up to press doctors' coats at a special lab coat press, and its pack room for OB/OR packs has custom-built light tables with eight fluorescent lights under each table. "We feel this improves the quality of our packs," McKay said.

Rose didn't start out with the idea of an all-new laundry. In fact, Systems Design was hired about four years ago to conduct a feasibility study on renovating an existing laundry at nearby University of Colorado Medical Center as a joint-venture laundry for both hospitals.

At that point, Osatinski said it was costing Rose $30,000-$40,000 a year in repairs and shut-downs at its own laundry as well as for outside linen service. A study by Osatinski's firm concluded that a 25%-30% cost reduction could be achieved by combining the two laundries and renovating CU Medical Center's 10,000-sq.-ft. laundry, which is in a free-standing building next to the power plant on the hospital's grounds.

"However, it is very difficult to try to put two institutions together," Osatinski said. The task was perhaps even more difficult because CU Medical Center is a state-run institution and



Our best laundry product is free.

Ashland carries everything you need to run a laundry: top performing detergents, bleaches, sours, mildewcides, softeners, even treatments to improve boiler operation and efficiency. In fact, we represent most leading producers of laundry products, and maintain local inventories at major cities throughout the South, Southeast and Midwest.

But our best laundry product is the service we deliver. Your Ashland representative can help with process recommendations, on-site product training, and trouble shooting. He'll help you develop an energy-saving program to cut fuel costs. He can even provide multiple plant inventory control, if you have more than one operation to manage. Put our local professional to work on your laundry needs. For information on products and our nearest location, write Industrial Chemicals & Solvents Division, Dept. TIP, P.O. Box 2219, Columbus, Ohio 43216.

Ashland®
Ashland Chemical Company
DIVISION OF ASHLAND OIL, INC.

For more data circle 80 on Fact Finder Card

Rose is a private hospital.

When the project was scrapped, Rose proceeded on its own, and the recommendation of Osatinski's firm concluded that Rose's "future need for space outweighs the benefits of renovating the existing laundry" which was in 6500-sq.-ft. of space on the lower level of the main hospital.

"We looked at the space, and it wasn't large enough to accommodate the most suitable system from the standpoint of energy and labor savings," Osatinski said. "So we recommended that the hospital go off-campus as the best way to reduce labor costs and cost-per-pound of the finished linen."

He explained that the cost savings at the new laundry come from (1) the fully automated wash/dry system which is expected to reduce labor costs by 30% versus labor costs at the old facility which were 60-65% of the total laundry operating costs, (2) a 20-30% reduction in utilities, mainly by the implementation of the thermal fluid system and the elimination of the high-pressure steam boiler with its high maintenance, (3) the use of the tunnel washer with low water consumption in relationship to the earlier washer-extractors, and (4) the use of the direct-fire water heater which is very efficient.

The linen service cost prior to the move was approximately 34.9¢ per pound for direct and indirect service bed-to-bed. The cost of linen at the new facility was estimated at 20-23¢ per pound at the time of the study, including bed-to-bed delivery and equipment depreciation as well as reserves for future equipment replacement.

During the search for a suitable location, Rose's administration and the hospital board decided to lease a building with excess space and move its whole materials management/purchasing department out of the hospital for further cost savings and to provide much needed space at the hospital.

"We didn't have adequate space on campus for support services," McKay said. "Rose, which is a teaching and research hospital, is growing rapidly. It has a new Women's Center and Diabetes Center, and it's going to open a Pediatric Center soon.

"The cost of space is very high at a hospital—$125 per sq. ft. at Rose—and we wanted to dedicate that space to patient care. It is less than $2 per square foot out here at the warehouse. It would cost more for a hospital to build its own laundry facility," LaNier added.

In addition to freeing approximately 10,000 sq. ft. of materials management/laundry space at the hospital for patient care, Osatinski said the move permits Rose to purchase in larger quantities, taking advantage of greater discounts. "This helps to reduce operating costs," he said. "Other hospitals should think about moving departments such as materials management and laundry off-campus, too. They can reduce operating costs that way."

McKay said materials management includes purchasing, central supply and the laundry. Broken down into the smallest unit, the departments off-campus include pharmaceutical storeroom, medical/surgical and food service.

"We're on the leading edge of progress here because we're a true, all-inclusive materials management system off-campus," McKay said. "We are in charge of procurement, storage, and distribution to all departments for

CHALLENGE
LAUNDRY EQUIPM
6-Pack Perfor
Rated

Folding 2,400 pieces per hour. Challenge 6-Pack is rated "superior" in commercial and institutional laundry installations everywhere. Simple straight-through action essentially eliminates jamming, provides accurate folding of thick pieces and even damp goods. The simple controls make operation easy, operator training rapid. It provides neater stacks of folded pieces than any other machine on the market. Its sturdy construction keeps it operating, keeps the work flowing.

Two Operator Feeding Speeds Production
Speed combined with reliability makes Challenge 6-Pack the only small piece folder that can accommodate two-operator feeding. Double up the feeding of items such as patient gowns or large bath towels, with all the accompanying economic advantages. Production rates can actually exceed the combined output of *TWO* competitive folders. 6-Pack is the only small piece folder with a speed that makes two-operator feeding practical and economical.

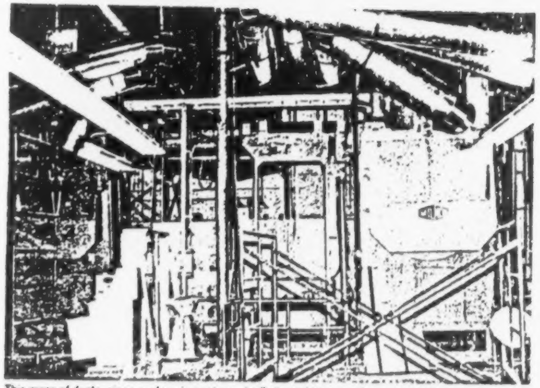
Sturdy Construction Extends Service Life
Challenge has a world-wide reputation for building laundry machinery that is sturdy and long-lasting. Compared with other folders you'll find 6-Pack's downtime for maintenance to be at a very minimum. Challenge uses heavier gauge metals, bigger, more powerful air cylinders, longer-lasting, precision belts, a heavier duty electric motor. The main belt is three-ply polyurethane with a textured surface for positive feeding.

6-Pack's 3-ply polyurethane main belt lasts four or five times longer than cotton belts.

Alternate Stacks of 10 and 15 to Make Stack of 25—Only Challenge Has It
Often the best way to prepare a [illegible] order is in bundles of 25, but a stack may be too high on the conveyor to [illegible] machine and too high to be conveyed [illegible] out falling over. With other folders you use two stacks to make up a bundle since 25 is not divisible by two. But [illegible] set your Challenge Six-Pack to deliver [illegible] of 10 and 15 alternately so any consec[illegible] pair can be combined to make a bundle [illegible] 25—another exclusive Challenge advan[illegible]

How Do You Like Your Folds?
The standard answer to the question [illegible] and neat. Challenge 6-Pack does just [illegible] And it does it better than any other [illegible] machine on the market. At 2,400 items [illegible] hour no other small piece folder handles [illegible] large a volume and so great a variety [illegible] consistent neat folding and stacking. Dry and damp pieces are handled routinely. Choose quarter fold or French fold [illegible] cross folding in halves, thirds or quarte[illegible] Versatile 6-Pack can easily produce the [illegible] package size and stack size to [illegible] your delivery system and available [illegible] spaces.

For more data circle 130 on Fact Finder [illegible]



This maze of ducts, pipes, and equipment eventually turned into a well organized plant.

direct and indirect needs of patient care, as well as disposal, accounts payable and reprographics (print shop), and we have an elaborate courier system all meant to network back to Rose."

At the point where the building was selected, a team of architects from the Kentros Group and Systems Design was commissioned to design and implement the master plan as outlined in the study. The warehouse provided a total of 17,000 sq. ft. of space for the laundry, 19,000 sq. ft. for materials management, and 4000 sq. ft. for the purchasing office.

The laundry opened with 15 FTEs, including Jesus Alarcon, assistant director of materials management/laundry, and Steve Cummings, laundry mechanic. It currently has 21 employees and is expected to require 4-5 FTEs for every additional million pounds of work.

For the new facility, Rose acquired three trucks with 24-ft. trailers which are used to transport all hospital supplies as well as linen to both Rose and the contract hospitals. A cart wash has hoses and a hose bib station which are available to sanitize the trucks as well as decontaminate the surgical and linen carts.

The laundry is using an exchange cart system, delivering its own linen directly to the floors at Rose. The laundry's new carts, which cost $900 each, are convertible. By putting up the shelves, they can be changed into soiled carts. Along with the required disposable plastic covers, they also have vinyl covers to protect the contents.

Carts are furnished with the contracts to other hospitals, and Rose currently has 84 of them which are enough for Rose and its outside accounts, figured on the basis of one in transport, one in the hospital and one in the laundry.

Soiled linen is sorted from a platform in front of the tunnel washer by employees who also work in the finishing area.

"One of the most important things at first was to learn how to load the washers correctly so everyone had something to do on the other side," Cummings said. "We have 36 different categories—everything from a variety of sheets to gown, surgical scrubs and baby burp pads. It's a matter of coordinating production with our help."

Cummings, whose main job is preventive maintenance, was involved during the shakedown period in the training of employees. Previously, the laundry did not have its own mechanic but was serviced by Rose's engineering department.

One of the challenges, according to Cummings, has been in handling the contract work, which cannot be mixed. If there is less than 100 lbs. to a load, the laundry sometimes leaves it overnight to add with the client's work for the next day. However, when the linen is needed by the client immediately, it is done in less than 100-lb. loads or else done in a 75-lb. washer/extractor and separate dryer in the drycleaning room. The small washer is intended to be used for baby items, new items that don't have a wash code formula for them, and other special applications.

The facility's computerized linen control system is able to handle any number of hospitals. Linen is weighed when it's loaded on the conveyors to the tunnel washers, and in addition to the washers' computers, a printer in Alarcon's office gives an automatic calculation and tabulation according to a direct linen conversion formula to determine the dry weight per load. Pieces are also automatically counted at the finishing stations to provide detailed linen control and comparison with soiled received. That system is available for all hospitals and should help them "reduce linen use as well as combat linen loss," Osatinski said.

The tunnel washers have six 200-lb. computer-controlled gas dryers, connected by shuttles. A lint collector behind the dryers pulls fine lint particles from the dryers and flushes them into disposable filter bags, which are discarded every day.

Sheets bypass the dryers after they have been extracted and go directly to the thermal-fluid ironers. The ironers are a 2-roll 36-inch diameter ironer and a 2-roll 27-inch diameter ironer. Each has a folder-crossfolder and stacker. Other equipment includes spreader-feeders, two small-piece folders for towels and gowns, the lab coat press and two utility presses for touch-up.

One of the folder-crossfolders, the small dryer and the two conventional pressing units were retained from the old laundry when it was closed. The other equipment sold last November. When the laundry closed, McKay pointed out that the steam pressure at the hospital's boilers was reduced because high-pressure steam was no longer needed.

Prior to the opening of the new laundry, Rose's linen was done by a commercial laundry, starting at 33c a pound and negotiated down to 22½c a

Once work is finished it is bulk shipped in plastic lined carts to outside users

pound as fuel prices dropped.

The new laundry's mechanical room houses the thermal fluid system to heat the ironers and provide steam for the pressing equipment. The thermal fluid heater uses neutral gas, and the steam generator (really a heat exchanger) is capable of producing up to 50 B.H.P. at 125 p.s.i.

Thermal fluid is not used to heat space or hot water in the Rose laundry because, according to Osatinski, the temperature fluctuation in Denver is not severe enough to require it and the cost of other forms of energy is cheaper.

The building was equipped with gas heat when it was leased, but it may not be needed often because of the heat generated by the equipment itself. The direct-fired water heater is so efficient it can bring the water up to 160°F in 8-10 minutes and maintain that tempefature throughout the day. Because of the thermal oil system and the flash heater, no boilers are required for the laundry, and hence, no boiler engineer is needed.

The New!
MASTER FOLD®
Folder/Cross Folder

Designed for years
of trouble free folding
from small tablecloths
to king size sheets

There's a model to meet
your specific needs

More details in Product News Section

b&bd inc.
Call us today. . .
42 MARCELLE AVENUE
AIRPORT INDUSTRIAL PARK
BIDDEFORD, MAINE 04005
207/282-5406

For more data circle 108 on Fact Finder Card

STRENGT
PRODUC
VAL-SOFT DEG
OPTI-ORTH
VAL-CHEM
For more data circle 145 on Fa

Chairman PICKLE. I thank the panel very much. You have been helpful to us this morning. Thank you.

Panel No. 2 consists of Bob Mayer, Tom Inman, Jerilyn Nettnin, and Mark Golden.

Bob Mayer, director of the National Association of Small Businesses Against Hospital Unfair Competition; Tom Inman, president, Virginia Home Medical; Jerilyn Nettnin, president, International Taxicab Association; and Mark Golden is vice president of the Association of Telemessaging Services.

We will first ask Bob Mayer to proceed.

STATEMENT OF ROBERT MAYER, MEMBER, BOARD OF DIRECTORS, NATIONAL ASSOCIATION OF SMALL BUSINESS AGAINST HOSPITAL UNFAIR COMPETITION

Mr. MAYER. Thank you, Mr. Chairman.

First I would like to specifically address the three questions that you referred to at the beginning of the first panel's testimony. The first question is, what specific nonprofit income-producing activities have caused you or members harm through unfair competition? Well, we specifically address nonprofit hospitals who establish for-profit, durable medical equipment companies.

Second, what is the unfair competition, and that is the competition from those very same durable medical equipment companies.

Specifically, which types of nonprofit organizations are engaged in these unfair activities? They are all nonprofit hospitals within the State of Michigan.

Thank you for the opportunity to appear before you at today's hearing. I am here today representing two separate groups which have both formed to address the problems I wish to call to your attention.

As members of this subcommittee are no doubt aware, in recent years the national bill for health care has been skyrocketing. One way in which costs can be controlled is to allow patients to recuperate at home, rather than in the hospital, whenever possible. Durable medical equipment, or DME, dealerships furnish medical equipment and supplies for use by such patients in their homes upon discharge from the hospital. Examples might be hospital beds and oxygen therapy equipment. DME dealerships, for the most part small businesses serving local areas, have been successfully meeting the needs of such patients for decades. My own business, Prescribed Oxygen Inc. in Plymouth, Mich., has been a family-run business for many years.

However, in recent years hospitals, most of them nonprofit, have invaded the DME business by creating for-profit DME subsidiaries, and have entered other businesses typically served by small entrepreneurs, such as ambulance services, pharmacies, and the like. Just in the last few years, unfair competition from hospitals has resulted in the demise of many such small family-owned and operated private firms across the Nation. In my own State of Michigan, 20 durable medical equipment dealerships from across the State have formed the Michigan DME Crisis Committee to address the common problems facing our businesses from such competition. Most recently, our group and a similar group from Virginia have realized that our common problems transcend both State lines and the durable medical equipment business, and so we are in the process of forming a national organization. This group will be called the National Association of Small Business Against Hospital Unfair Competition, or NASBAHUC. I am a member of the board of directors of NASBAHUC.

I would like to address three areas of particular concern to NASBAHUC and the Michigan DME Crisis Committee. First, transfers of assets; second, captive referrals; and third, the systematic abuse of the 1982 Nonprofit Institutions Act.

Basically the problem is the unfair use of the advantages accruing to a tax-exempt section 501 organization in competing with nonsection 501 businesses in the marketplace. Unfair competition in this industry by nonprofits takes two forms.

First, there is frequent subsidization of the hospital DME companies by the institution which controls them. This subsidization can take many forms, some subtle and some quite blatant. Nonprofit hospitals feel free to use their personnel to set up medical equipment in the homes of patients who purchase such equipment from the for-profit hospital DME subsidiary. Usually no charge is made to the for-profit subsidiary for the labor provided by the nonprofit parent organization. I have to pay someone to do this and charge accordingly. Nonprofits can and do bury these costs in patient charges. Nonprofits subsidize for-profit DME subsidiaries in other ways as well. For instance, use of the hospital computer to keep for-profit records and to generate bills for the for-profit subsidiaries is the rule, not the exception. Section 501 hospitals frequently allow their for-profit DME subsidiaries to use space in the hospital building or offices and equipment storage at low or no cost.

With nonprofit section 501 hospitals providing this kind of indirect economic support to for-profit subsidiary DME companies, it is clear that substantial non-cash investment of nonprofit resources is being made in the for-profit ventures of these institutions. Additionally, however, there is direct financing of the for-profit subsidiaries by the nonprofit parent hospital.

The financing of for-profit subsidiaries by nonprofit hospitals is troubling in that nonprofit institutions accumulate large sums of money which are considered by many to be held in trust for charitable purposes. These sums are not taxed by any governmental bodies. They are then used to capitalize businesses indistinguishable from existing private enterprise. For-profit subsidiaries of section 501 hospitals frequently are under no meaningful obligation to pay back the funds used to capitalize the business, much less to pay them back at commercial interest rates which private competitors of the subsidiary business must pay.

The second major issue is captive referrals. An additional feature of the hospital marketplace which puts hospitals in a uniquely powerful position in the durable medical equipment market is that they, the hospitals, control the vast majority of patient referrals. While somewhat to the side in the subcommittee's consideration of taxation aspects of the nonprofit/for-profit issue, the hospitals' position at the chokepoint of our marketplace is of vital importance to independent DME and home health businesses.

Referrals are the lifeblood of independent DME businesses. When hospitals set up their own subsidiary DME and home health care businesses, they almost invariably begin to squeeze off the flow of referrals to independent DME dealers and divert that flow to the subsidiary for-profit DME and/or home health dealership. This phenomenon is known in the industry as captive referral.

Captive referrals by section 501 and other hospitals to for-profit subsidiaries are destroying the independent DME dealers of this country.

Finally, this subcommittee should be aware that there is massive violation of the 1982 Nonprofit Institutions Act, 15 U.S.C. section 13(c), in the hospital industry. Drugs and equipment of all kinds are routinely purchased at below-market prices by the section 501 hospital and then given to the for-profit subsidiary for resale in direct competition with private independent DME businesses. The prices charged by these for-profit subsidiaries of the nonprofit hospitals are often below the wholesale price at which the drug or other product is available to other businesses in the marketplace.

On behalf of my organizations, I thank you for your attention to my testimony. I will be glad to answer questions.

Mr. FLIPPO. I think we will have the testimony of all our witnesses before we go to questions.

Mr. Inman, please proceed.

STATEMENT OF THOMAS E. INMAN II, PRESIDENT, VIRGINIA HOME MEDICAL

Mr. INMAN. Thank you, Mr. Chairman.

Acting on behalf as president of Virginia Home Medical, and as a board member of NASBAHUC, the purpose of my submitting testimony before this committee is to help the members of the committee better understand two specific types of unrelated business income which are being generated by nonprofit health organizations.

Both of these types of activities are inherently unfair to the taxpaying small business community, and beyond that they may well evolve into a broader strategy, which when expanded, will cause serious casualties to small business and, thus, a negative impact on the 37 percent of GNP, which small business represents to this nation.

The first type of income I will describe comes from a first-hand experience our company had in the early 1980s. We had invested approximately $50,000 in home infant monitors, as a result of new product technology and community need.

Our home monitoring program had become accepted by local physicians and parents alike, for those newborns who were identified as being at-risk to Sudden Infant Death Syndrome [SIDS). One of our local nonprofit hospitals conducted an annual fund raising event, which was sponsored by a local service sorority. For this particular year, the 1-day event raised over $29,000. Included in the next issue of the hospital's newsletter was a feature story with a picture of the sorority officers presenting the donation check to hospital officials. Within the body of the article, the statement was made which indicated that approximately $15,000 of the donated funds were going to be used to purchase home infant monitors for the hospital's patients. As a direct result of the diversion of the donated nontaxed funds into a questionably unrelated business activity, we have suffered severe business consequences. Additionally, once a nonprofit entity becomes aware of this method of free venture capital, they can duplicate it over and over again specific to their areas of interest.

The second type of income I would like to describe for the committee is that which is occurring in the health care industry on a daily basis. Directly related to the onset of prospective payment to hospitals by the Medicare program, nonprofit hospitals across the country initiated complex structural reorganizations in an attempt to remove certain types of activities and incomes from direct scrutiny. These structural changes characteristically have a non-profit holding company, or foundation, owning a multilayered group of entities; some of which are for-profit and others are not-for-profit. The point to be made here is that the Internal Revenue Service allows for the integration under common ownership of both for-profit, and not-for-profit entities. With this type of legal structure, defining unrelated business income or activities for the whole organization becomes a very difficult task.

Given the above-referenced state of affairs, a closer look into the possible flow of income versus donations—as mentioned in the first example—and profits is warranted. Appendix A, outlines two for-profit companies, with the only difference in them being that one is owned by a nonprofit entity. I might add that these are two regular corporations. It becomes apparent on the face of the data, one layer of taxation is being avoided by this nonprofit ownership at the point when dividends are distributed to stockholders. However, there is a far more ominous transaction which has the small businessman concerned. That transaction is the specific incentive to take full advantage of the Federally allowed 10 percent tax deductible contribution to a 501 corporation. The facts slap small businessmen in the face, when they come to realize that a tax-deductible contribution, not only reduces the taxes to be paid, but also acts as a tax-free dividend distribution when it is made to the parent 501 holding company or another member of the family of 501 corporations under the parent-holding company.

Gentlemen, I submit to you that when this type of economic control and power sanctioned by the government and allowed to continue over the next decade, there will be a redistribution of taxes off of the small business community, due to their decreasing numbers, and onto the individual taxpayer. The reason I make such a strong statement is that when the total of the transactions are evaluated for their economic impact on both small business, and the tax base, one fact becomes clear: fair competition is impossible. The bottom line for the 501-owned, for-profit corporation after dividend distribution, and the receipt of the up-front 10 percent donation, is that the holding company strategy equates to a 76 percent tax advantaged economic position over an individually owned corporation. Additionally, with these advantaged dollars, the holding company is now free to use them as venture capital to expand its economic base.

The point to be made here is that we find ourselves in the dilemma of not only asking questions relevant to defining unrelated business income, but more importantly, how the laws affecting the structure of multilayered hybrid nonprofit organizations allows them to legally escape scrutiny related to unrelated business income. This is due to extremely broad mission statements, common boards of directors, and continued use of tax free dividends as venture capital to expand their organizations.

In closing, I would like to say that I share this committee's concerns in taking a fair and objective look at the facts surrounding this issue. Currently, I am serving as a citizen member to a joint subcommittee of the Virginia General Assembly. We, too, are addressing the issue of unrelated business income as one aspect of our study of unfair competition between nonprofit organizations and the small business community in the Commonwealth. This issue is vital to the future economy of our Nation and to the continued contributions the small businessman will be allowed to make to this Nation in the decades to come.

Thank you.

[The prepared statement and a letter subsequently received follow:]

Statement of Thomas E. Inman II

Mr. Chairman, and Members of the Committee

My name is Thomas E. Inman, II and I am President of Virginia Home Medical. My company is a 10-year old small business in Newport News, Virginia, with branches in Norfolk and Chesapeake. Our mission is that of supplying medical equipment and supplies to individuals suffering from either chronic or terminal illnesses. The majority of our activity takes place in a persons home after we are contacted by a referral source. Some examples of our product line include home oxygen therapy, enteral feeding therapy, hospital beds, wheelchairs, and other special or customized rehabilitation products.

The purpose of my submitting testimony before this committee is to help the members of the committee better understand two specific types of unrelated business income which are being generated by non-profit health organizations. Both of these types of activities are inherently unfair to the tax paying small business community and beyond that they may well evolve into a broader strategy which when expanded will cause serious casualties to small business and thus a negative impact on the 37% of GNP which small business represents to this nation.

The first type of income I will describe comes from a first hand experience our company had in the early 80's. We had invested approximately $50,000. in home infant monitors as a result of new product technology and community need. Our home monitoring program had become accepted by local physicians and parents alike, for those newborns who were identified as being at risk to sudden infant death syndrome (SIDS). One of our local non-profit hospitals conducted an annual fund raising event which was sponsored by a local service sorority. For this particular year, the one-day event raised over $29,000. Included in the next issue of the hospital's newsletter was a feature story with a picture of the sorority officers presenting the donation check to hospital officials. Within the body of the article, the statement was made which indicated that approximately $15,000. of the donated funds were going to be used to purchase home infant monitors for the hospital's patients. As a direct result of the diversion of the donated non-taxed funds into a questionably "non-related" business activity, we have suffered severe business consequences. Additionally, once a non-profit entity becomes aware of this method of "free venture capital", they can duplicate it over and over again specific to their areas of interest.

The second type of income I would like to describe for the committee is that which is occurring in the health care industry on a daily basis. Directly related to the onset of prospective payment to hospitals by the Medicare program, non-profit hospitals across the country initiated complex structural reorganizations in an attempt to remove certain types of activities and incomes from direct scrutiny. These structural changes characteristically have a non-profit holding company or foundation owning a multi-layered group of entities; some of which are for-profit and others are not-for-profit. The point to be made here is that the Internal Revenue Code allows for the intergration under common ownership both of for-profit and not-for-profit entities. With this type of legal structure defining non-related business income or activities for the whole organization becomes a very difficult task.

Given the above referenced state of affairs a closer look into the possible flow of income vs. donations, (as mentioned in the first example) and profits is warranted. Appendix A outlines two for-profit companies with the only difference in them being that one is owned by a non-profit entity. It becomes apparent that on the face of the data, one layer of taxation is being avoided by this non-profit ownership at the point when dividends are distributed to stockholders. However, there is a far more omnious transaction which has the small businessman concerned. That transaction is the specific incentive to take full advantage of the federally allowed 10% tax deductible contribution to a 501 corporation. The facts slap small buinessmen in the face when they come to realize that a tax-deductible contribution not only reduces the taxes to be paid, but also acts as a non-taxed, tax free, dividend distribution when it is made to the parent 501 holding company or another member of the family of 501 corporations under the parent-holding company.

Gentlemen, I submit to you that when this type of economic control and power sanctioned by the government and allowed to continue over the next decade, there will be a redistribution of taxes off of the small business community, due to their decreasing numbers, and onto the individual taxpayer. The reason I make such a strong statement is that when the total of the transactions are evaluated for their economic impact on both small business and the tax base one fact becomes clear: fair competition is impossible. The bottom line for a 501 owned for-profit corporation after dividend distribution, and the receipt of the up-front 10% donation is that the holding company strategy equates to a 76% tax advantaged economic position over an individually owned corporation. Additionally, with these advantaged dollars the holding company is now free to use them as "venture capital" to expand its economic base.

The point to be made here is that we find ourselves in the dilemma of not only asking questions relevant to defining unrelated business income, but more importantly how the laws effecting the structure of multi-layered hybrid organizations allow them to legally escape scrutiny relative to non-related business income due to extremely broad mission statements, common boards of directors and continued use of "tax-free" dividends as venture capital to expand their organizations.

In closing, I would like to say that I share this committee's concerns in taking a fair and objective look at the facts surrounding this issue. Currently I am serving as a citizen member to a Joint Subcommittee of the Virginia General Assembly. We, too, are addressing the issue of non-related business income as one aspect of our study of unfair competition between non-profit organizations and the small buiness community in the Commonwealth. This issue is vital to the future economy of our nation and to the continued contributions the small businessman will be allowed to make to this nation in the decades to come.

APPENDIX A

NET EQUITY ANALYSIS FOR
TWO FOR PROFIT CORPORTATIONS

	Non-profit Ownership	Taxable Ownership
Taxable Income	1,000,000	1,000,000
10% Tax Deductible Contribution	100,000	100,000
Net Taxable Income	900,000	900,000
Est. Corp.Taxes	300,000	300,000
Net Income Available For Distribution	600,000	600,000
Taxes On Total Distribution Individual Rate @ 28% Federal	-0-	168,000
Individual Rate @ 5.75% State		34,500
Total Taxes On Dividend Distribution	-0-	202,500
Net Effect To Stockholders	600,000 + 100,000 (Donation)	600,000 - 202,500 Taxes
	700,000	397,500

Mr. FLIPPO. Thank you, Mr. Inman.

Mrs. Nettnin.

STATEMENT OF JERILYN NETTNIN, PRESIDENT, INTERNATIONAL TAXICAB ASSOCIATION

Mrs. NETTNIN. My name is Jerilyn Nettnin; I am president of Blue Cab Co., in Oak Park, Ill. I am testifying today in my capacity as president of the International Taxicab Association.

Our trade association represents over 500 private, taxpaying taxicab and paratransit companies in the United States. Our members provide necessary public transportation in every major American metropolitan area, as well as numerous rural counties and municipalities.

As a matter of fact, half of this country's taxicab and other paratransit vehicles operate outside of the 100 largest population centers.

Taxicab operators and paratransit companies, both ITA members and nonmembers, fleet operators and independents, face competition from governmental and private, nonprofit transportation providers who are rarely funded by traditional charitable contributions, but instead rely on Federal and State capital grants, operating subsidies, and contracts for their funding.

To a large degree, the services provided by these tax-exempt organizations are identical to those provided by commercial taxicab and paratransit companies.

Their establishment and growth has been enabled by favorable IRS rulings, even though the benefits they provide the community are no different than those provided by our taxable businesses.

ITA acknowledges that the competition from tax-exempt organizations faced by taxicab and paratransit service providers is not solely the result of inequities in the Internal Revenue Code or in its administration by the IRS. Some solutions must come from other sources, principally the Urban Mass Transportation Administration and the Department of Health and Human Services.

Nevertheless, because Federal and State government grants and contracts to tax-exempt providers are most often contingent upon, or favorably influenced by their tax-exempt status, amendments to the Internal Revenue Code are an important complement to positive action by these agencies.

Accordingly, ITA recommends that the following three actions be taken to amend the Internal Revenue Code or to improve its administration:

One, section 501(c) or the regulations thereunder should be amended to state that the operation of common carrier-type transportation services is not an exempt purpose that may be recognized under section 501(c)(3) or 501(c)(4).

Two, section 501(c)(3) or the regulations thereunder should be amended to state that the operation of common carrier-type transportation services is not considered to lessen the burdens of government.

Three, IRS should be instructed to examine more carefully the applications for exemption, and the operations for nonprofit transportation providers to ensure that they are serving a truly charitable class of individuals.

We believe that adoption of these recommendations will do much to improve the administration of the law governing exempt organizations, reduce unfair competition from nonprofit transportation providers faced by taxicab and paratransit companies, and improve the transportation service available to the elderly and handicapped.

Mr. Chairman, this concludes my remarks. I will be happy to respond to any questions.

[The statement of Mrs. Nettnin and a letter subsequently received follow:]

TESTIMONY
before the
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

by

JERILYN NETTNIN
PRESIDENT
INTERNATIONAL TAXICAB ASSOCIATION
3849 Farragut Avenue
Kensington, Maryland 20895

Mr. Chairman and Members of the Subcommittee:

My name is Jerilyn Nettnin; I am President of Blue Cab Co., in Oak Park, Illinois, and I am testifying before you today in my capacity as President of the International Taxicab Association (ITA). I am pleased to have this opportunity to present ITA's views regarding the tax treatment of exempt organizations.

The International Taxicab Association ("ITA") is the trade association representing 611 taxicab and paratransit companies throughout the world. 536 of those companies provide necessary public transportation services in every major metropolitan area in America, as well as in many rural counties and municipalities. "Paratransit" companies provide a range of public transporation services, including taxicabs, livery, vans, and mini-buses. These services may be scheduled or "on-call," and are often targeted to the elderly and handicapped, using specially modified equipment.

ITA, which is itself an exempt trade association described in section 501(c)(6) of the Internal Revenue Code, appreciates the enormity of this Subcommittee's task in reviewing the tax treatment of tax-exempt organizations. While this Subcommittee will be examining many issues, we are here to testify about the one issue that ITA members are most concerned about: unfair competition between taxable taxicab and paratransit companies on one hand, and private, tax-exempt transportation providers on the other hand.

As an exempt organization itself, ITA, along with its members, believes that the present concepts and structure of the Internal Revenue Code provisions establishing the conditions for exemptions and requiring exempt organizations to pay tax on their income from unrelated businesses are essentially sound. We do not believe that any basic changes are required. Our concern is, therefore, limited to a competitive problem generated by changes in our society and in the IRS' administration of the law.

UNFAIR COMPETITION BY NONPROFIT TRANSPORTATION PROVIDERS

A. In general. Taxicab operators and paratransit companies, both ITA members and non-members, fleet operators and independents, face competition from governmental and private, nonprofit transportation providers who are rarely funded by traditional charitable contributions, but instead rely for their funding on Federal and state capital grants, operating subsidies, and contracts.

A typical situation occurs when a suburban or rural county government determines that transportation assistance should be provided to elderly and handicapped citizens. In most cases, a private, nonprofit, tax-exempt organization will be selected to provide these services, even though in many cases a local, taxable business submitted a lower cost bid using equally appropriate equipment. In some cases, the organization will be one that has already been providing transportation services incidental to its principal acitivities. For example, a retirement home that transports its residents to shopping or on field trips may expand its existing services. In other cases, a new organization will be formed specifically to take advantage of the available government funds.

Because the elderly and handicapped comprise over 40 percent of suburban and rural taxicab users, the subsidized services provided by the new tax-exempt provider inevitably draw clients away from the taxable businesses. In some cases, the establishment of such service has been the direct cause of the failure and bankruptcy of the taxable business.

In one case involving an ITA member, a nonprofit tax-exempt organization decided not to pursue a capital grant application when the local government supervisory agency proposed to require it to lease the equipment to a taxicab company that had offered to provide the same service proposed by the non-profit organization at 60 percent of the cost. The same non-profit agency was subsequently found to have built up a hidden reserve of $100,000 from operating contracts it repeatedly obtained from the county government even though its bids were 60 to 75 percent higher than that of the taxicab company that was also bidding for the contracts. While this is perhaps an extreme example, it highlights the nature of the competition that taxicab and paratransit companies face from "nonprofit" providers.

This competition between taxable businesses and nonprofit transportation providers results entirely from the relatively recent entry of tax-exempt providers, who are largely, if not totally, dependent on government grants and contracts, into an activity that has long been fully and adequately served by taxable transportation businesses, and that has only recently been considered in any way a charitable activity.

B. The specific problems faced by taxicab and paratransit companies are:

1. The IRS has ruled that private, non-profit transportation providers may be tax-exempt under sections 501(c)(3) or 501(c)(4) of the Internal Revenue Code. In several instances, the Internal Revenue Service has concluded that nonprofit organizations whose principal purpose and activity is to provide common carrier transportation service may be tax-exempt under §501(c)(3) or §501(c)(4). For example, in Rev. Rul. 78-68, 1978-1 C.B. 149, the IRS ruled that a nonprofit organization that provided supplemental bus service (otherwise provided by a city-subsidized program) under a Model Cities demonstration project was a charitable organization under §501(c)(3). The same conclusion was reached in G.C.M. 38923 (Aug. 6, 1982), concerning a state-funded, nonprofit organization that provided transportation to commuters in cars and vanpools. These organizations were determined to be "lessening the burdens of government," a charitable function, simply because they were principally

funded by Federal or state government grants and contracts, and without regard to whether they served a charitable class of patrons. A similar situation was addressed in Rev. Rul. 78-69, 1978-1 C.B. 156, in which the IRS ruled that a government-subsidized, nonprofit, commuter bus system is tax-exempt under §501(c)(4) because it "promotes the social welfare" of the community.

To a large degree, the services provided by these tax-exempt organizations are identical to those that are provided by commercial taxicab and paratransit companies. Their establishment and growth has been enabled by favorable IRS rulings, even though the benefits they provide the community are no different than those provided by taxable businesses. In the IRS' own words, these organizations are providing services of a type that are provided by "ordinary commercial businesses," and should not be converted into tax-exempt groups merely because they are organized as nonprofit corporations and wholly supported by government funding. In all other respects, they are transportation companies.

I wish to point out that, although ITA is sympathetic to the problems faced by many elderly and handicapped individuals, these groups should not necessarily be treated as charitable classes of people. Many of the elderly and handicapped are quite mobile, have their own vehicles, or can afford and use ordinary forms of public transportation, including buses and taxicabs. They are not, as the IRS has recently said, "impoverished, underprivileged, or similarly distressed." GCM 39633 (May 13, 1987).

The tax-exempt status of these nonprofit transporation providers has resulted in two specific problems for taxable taxicab and paratransit companies:

a. Government funding through grants or contracts is most often contingent on, or favorably influenced by, the tax-exempt status of an organization. Because of the preference for "private, nonprofit" (tax-exempt) organizations that appears in the §16(b)(2) of the Urban Mass Transportation Act, 49 USC §1612(b)(2) (governing grants for transportation services to the elderly and handicapped), many tax-exempt transportation providers have been able to win grants or contracts that cost the Federal, state, and local governments many thousands of dollars more than would have been required to obtain the same service from a taxable business. These direct costs are increased by the loss of income taxes and, in the case of services provided by §501(c)(3) organizations, unemployment taxes that would have been paid by taxable businesses.

b. The tax-exempt status of nonprofit transporation providers enables them to underbid taxable businesses in providing non-charitable services. In many instances, taxicab and paratransit companies find that competing tax-exempt providers are able to underbid them for government grants and contracts to provide transporation services to non-charitable classes of persons. This is the exact abuse that the unrelated business income tax was designed to remedy. The difficulty here is that the IRS has administered the law improperly by granting tax-exempt status to organizations whose primary purpose and activity is to provide transportation services to a non-charitable class of persons.

2. Some tax-exempt transportation providers actually operate as common carriers. Some "dial-a-ride" services, which are tax-exempt providers of transportation services to the elderly and handicapped, have been found to be operating in violation of the conditions of their grants and contracts by transporting anyone who calls for a ride, regardless of their eligibility for the program. Even if the elderly and handicapped may be considered a charitable class of individuals, these organizations are providing simple, commercial transportation service to a class of beneficiaries--the general public--that is not a charitable class. They should not be tax-exempt.

RECOMMENDED SOLUTIONS

A. ITA acknowledges that the competition from tax-exempt organizations faced by taxicab and paratransit service providers are not solely the result of inequities in the Internal Revenue Code or in its administration by the IRS. Some solutions must come from other sources, principally the Urban Mass Transportation Administration, the Department of Health and Human Services, and state social service agencies. Nevertheless, because Federal and state government grants and contracts to tax-exempt providers are most often contingent upon, or favorably influenced by their tax-exempt status, amendments to the Internal Revenue Code are an important complement to positive action by these agencies.

B. Accordingly, ITA recommends that the following actions be taken to amend the Internal Revenue Code or to improve its administration:

1. Section 501(c) or the regulations thereunder should be amended to state that the operation of common carrier-type transportation services is not an exempt purpose that may be recognized under section 501(c)(3) or 501(c)(4). ITA does not object to a nonprofit organization providing transportation to a charitable class of individuals incidental to its principal activities. For example, a retirement home that provides transportation for its impoverished residents to and from local shopping, medical, or cultural facilities is providing transportation to a charitable class of persons incidental to its principal purpose. When, however, the same home expands its service to other nonprofit organizations, or to the public at large (or the elderly and handicapped at large), the new activity does not serve its exempt purpose and should not be permitted.

2. Section 501(c)(3) or the regulations thereunder should be amended to state that the operation of common carrier-type transportation services is not considered to "lessen the burdens of government," within the meaning of Treasury Regulation §501(c)(3)-1(d)(2), unless the government has historically provided or funded the service, or there are no private, non-charitable businesses that provide comparable service. Revenue Ruling 78-68 and GCM 38923 concluded that the subject nonprofit transportation services were charitable because they "lessened the burdens of government" within the meaning of Treasury Regulation §1.501(c)(3)-1(d)(2). This lessening of the burdens was demonstrated by the government's commitment of significant funds to subsidize the service. However, in neither case was it demonstrated that necessary, appropriate, and convenient service was not being, or could not have been, provided by private, taxable businesses. We do not believe that the Federal

treasury can afford a definition of "the burdens of government" that expands as infinitely as the governmental purse has grown in our modern age. We live in an age when the entire spiritual, mental, social, physical, and economic well-being of each individual is considered to be "the burden of government." To permit any organization that operates as a nonprofit corporation to unfairly compete against taxable businesses merely because the government has determined to fund an activity stretches the historical and, we believe, proper meaning of "the burdens of government" beyond recognition.

3. The IRS should also be instructed to examine more carefully the applications for exemption and operations of nonprofit transporation providers to ensure that they are serving a truly charitable class of individuals. Such providers must be examined to ensure that they are actually providing services to those who are "impoverished, underprivileged, or similarly distressed," who need service not provided or available through commercial businesses.

CONCLUSION

ITA believes that adoption of its recommendations will do much to improve the administration of the law governing exempt organizations, reduce the unfair competition from nonprofit transportation providers faced by taxicab and paratransit companies, and improve the transportation service available to the elderly and handicapped. We would be pleased to work with the Subcommittee and its staff, in coordination with our counsel, to draft legislative language that will accomplish this goal.

Mr. Chairman, this concludes my prepared statement, and I will be happy to respond to any questions that you or other Members of the Subcommittee may have. I and the members of the International Taxicab Association thank you for the opportunity to testify today.

Mr. **Flippo.** Mr. Golden.

STATEMENT OF MARK J. GOLDEN, VICE PRESIDENT, ASSOCIATION OF TELEMESSAGING SERVICES INTERNATIONAL, INC.

Mr. **Golden.** Thank you very much.

I am Mark Golden, vice president of the Association of Telemessaging Services International (ATSI). ATSI is the trade association which represents the telemessaging service bureau industry, which consists primarily of live telephone answering service or TAS bureaus.

The medical community has always been a major market for the telephone answering service industry; approximately one third of the live TAS customer base in the United States are members of the medical professions.

Increasingly, however, the TAS industry has faced competition for its medical market from in-house TAS operations established by tax-exempt hospitals.

The TAS industry has become very concerned with this situation. It is more than an issue of additional competition; the TAS industry has always been fiercely competitive.

TAS industry concern arises because hospital bureaus tend to charge far below market rates; rates which the TAS, with its own cost experience, knows cannot possibly be fully compensatory. This raises the concern that public money is being used to subsidize a competitive offering.

It should be stressed that the services offered by hospital TAS are not hospital related. Many hospital TAS bureaus are aggressively marketing their services to nonstaff physicians and to commercial, nonmedical accounts.

Most hospital TAS bureaus price their service at levels well below the rates charged by nonhospital affiliated bureaus in their areas and at rates which cannot possibly be compensatory.

Many cases elaborated upon in my written statement suggest that the cost of providing the service is not even considered by the hospital TAS in establishing a price for its service.

Instead, price is established based on what the doctor is paying to his or her existing service, indicating an interest in establishing market share at any cost, rather than in achieving a self-sustaining operation.

My written testimony presents numerous examples of hospital TAS operations and comparisons between what the hospital TAS is charging for service and the marketprice, for such services as indicated by the rates charged by established for-profit operations in their area.

Labor costs are also highlighted and compared, since they form such a significant part of the cost of providing answering service, typically constituting 40 to 60 percent of an answering bureau's gross receipts. In case after case, the rates being charged by the hospital fail to cover the labor costs for even a minimally staffed operation, let alone the other operational costs.

If not from the rates it charges for the services it is providing, from where, then, are these hospital organizations receiving their operating revenues? We believe in many cases that Federal, State, and local tax supported resources are being used to subsidize an unrelated business activity in a manner which gives the hospital TAS a competitive advantage over private, nonsubsidized operations.

We in the messaging industry understand that recent changes in Medicare and private insurance practices caused dramatic and even traumatic changes in how the hospital is compensated and the levels of reimbursements that it receives for medical services provided.

We understand that this has compelled hospitals to seek new sources of revenue and to offer services and benefits which will attract doctors to their facilities. This does not, however, justify the leveraging of advantage enjoyed in their status as nonprofit tax-exempt institutions to establish, fund, and maintain competitive operations which face no reasonable probability of ever being financially viable, particularly where commercial taxpaying entities in their communities are harmed by this competition.

This is just what we see occurring in the messaging marketplace today.

In conclusion, hospitals are charging significantly lower rates although they face generally considerably higher labor costs, again with labor being the single most important factor in determining an answering bureaus cost of doing business.

There is significant evidence of hospitals competing with commercial taxpaying entities in the TAS market at prices which are clearly based on market capturing motives and which do not cover the actual costs of providing services. Admittedly TAS bureaus have experienced challenges from startup commercial TAS operations which similarly underprice service in an attempt to gain market share. Such operations, however, must eventually raise prices to recover costs or they eventually go out of business. Tax-exempt hospital-supported TAS operations, however, appear to be operating with a grant of special immunity to these realities in the marketplace. Although generating revenues at levels well below their costs for doing business, they continue to operate and to lure customers away from commercial TAS operations.

We urge the Congress to seriously evaluate the extent to which tax-exempt organizations such as hospitals are permitted to engage in such commercial activities and improve the enforcement of the existing legislation.

Thank you.

[The statement of Mr. Golden follows:]

Statement of
ASSOCIATION OF TELEMESSAGING SERVICES INTERNATIONAL

My name is Mark J. Golden. I am Vice President of the Association of Telemessaging Services International (ATSI). ATSI is the trade association which represents the telemessaging service bureau industry, which consists primarily of live telephone answering service (or TAS) bureaus.

The TAS industry comprises over 4,200 service bureaus in the United States, serving over 1.2 million subscribers. ATSI has over 1,000 of these bureaus in membership; its member bureaus provide service to about 50% of the customers of live TAS in this country today.

The medical community has always been a major market for the telephone answering service industry: approximately one third of the live TAS customer base in the United States are members of the medical professions. (Additional background on the TAS industry is included as Attachment I).

Effective and efficient messaging is a critical aspect of health care delivery. Twenty-four-hour-a-day telephone response for patients and a means of conveying messages to practitioners-on-the-move are inseparable from modern health care.

Increasingly, however, the TAS industry has faced competition for its medical market from in-house hospital TAS operations. In some cases, the suppliers of the equipment which TAS bureaus use are encouraging and even providing training and consulting expertise for hospital start-up of in-house TAS operations.

The TAS industry has become very concerned with this situation. It is more than an issue of additional competition: the TAS industry has always been fiercely competitive. TAS industry concern arises because we believe the hospital competition to be unfair in that such bureaus tend to charge far below market rates: rates which the TAS, with its own cost experience, knows cannot possibly be fully compensatory. This raises the concern that public money is being used to subsidize a competitive offering.

As will be demonstrated in specific examples below, our industry's experiences in the face of this new and increasing competition from the hospital community demonstrate exactly the type of situation in which non-profit, tax exempt organizations unfairly disadvantage commercial, tax paying entities in the marketplace. Specifically:

Services offered by hospital TAS often are not hospital-related. The customer lists of hospital TAS operations are not limited to the physicians on the hospitals' staffs. Many hospital TAS bureaus are aggressively marketing their services to non-staff physicians and to commercial, non-medical accounts. Even where the client base is primarily doctors with privileges at the hospital, the service is provided for their convenience, and to support their activities in their capacity as private physicians in private practice.

Most hospital TAS bureaus price their service at levels well below the rates charged by non-hospital affiliated bureaus in their area and at rates which cannot possibly be compensatory. Many cases suggest that the cost of providing the service is not even considered by the hospital TAS in establishing a price for its service. Instead, price is established based on what the doctor is paying to his or her existing service, indicating an interest in establishing market share at any cost, rather than in achieving a self-sustaining operation.

The major cost of providing telephone answering service is labor cost. Typically, an answering bureau spends between 40% and 60% of its gross receipts on wages for its staff. Hospital TAS operations consistently face significantly higher costs in this major cost area than do non-hospital, commercial TAS enterprises. Hospital TAS operations typically pay higher hourly wages than the outside TAS pays its staff. The hospitals also tend to offer significantly higher levels of employee benefits to its staff, further increasing its cost of service. Nonetheless, rates charged by hospital TAS operations are typically much lower than those charged commercially in their market area. No extraordinary efficiencies are available to the hospital to offset their higher labor cost factor or justify this price differential.

Hospitals often provide their TAS operations with use of hospital office space, utilities, telephone facilities, other overhead items, and even telephone/receptionist personnel. In some cases, there is no charge to the TAS operation for this support. Other times, hospitals attribute costs to their TAS operations at unrealistically low rates or in an arbitrary manner.

We, in the messaging industry, understand that recent changes in Medicare and private insurance practices have caused dramatic and even traumatic changes in how a hospital is compensated and even the levels of remimbursement that it receives for medical services provided. This has compelled hospitals to seek new sources of revenue and to offer services and benefits which will attract doctors to their facilities. This does not, however, justify the leveraging of advantages enjoyed in their status as non-profit, tax exempt institutions to establish, fund and maintain competitive operations which face no reasonable probability of ever becoming financially viable, particularly where commercial, tax-paying entities in their communities are harmed by this unfair competition.

This is just what we see occurring in the messaging marketplace today. Briefly stated below are examples of hospitals offering TAS services, demonstrating the inappropriateness of their pricing or marketing practices. These examples were brought to our attention by ATSI member bureaus in these hospitals' communities: tax paying entities who are suffering serious loss of business and an erosion of profitability as a result of the hospitals' actions.

This very brief comparison of what hospital TAS operations are charging for service and the market price for such service (as indicated by the rates charged by established, for profit operations in the same area) demonstrate that such hospital operations cannot possibly be receiving revenues equal to their cost of providing service. If not from the rates it charges for the service it is providing, from where, then, are these hospital run organizations receiving their operating revenues? We believe, in many cases, that federal, state, and local tax supported resources are being used to subsidize an unrelated business activity in a manner which gives the hospital TAS a competitive advantage over private, non-subsidized enterprises.

MERCY HOSPITAL
Charlotte, North Carolina

Mercy Hospital's TAS operations have recently expanded to provide service not only to doctors, but to businesses as well. According to press statements, the hospital TAS is "now the answering service for realtors, property managers of apartment complexes, distributors, mortgage companies, and other types of operations." (Charlotte Observer, September 1, 1986. Attachment II).

The hospital TAS, by its own volition, has succeeded in attracting new business customers by offering a "very competitive monthly charge for unlimited calls" for daytime service. For its 24-hour-a-day clients, Mercy charges a base rate which is also significantly lower than that being charged by bureaus in the community and includes a higher number of calls in that base rate. In fact, Mercy offers discounts for high call volume accounts. Such a "volume discount" reduces the revenue per call answered which is generated for the bureau and undermines the profitability of a TAS operation. The volume of calls that a bureau's customer receives dictates the level of staffing that the TAS must provide. The higher the call volume, the higher the level of staffing required. Since labor costs typically account for so much of a messaging bureau's cost of doing business (typically 40% to 60%), increases in staffing directly and dramatically increase revenue requirements. Under Mercy Hospital's pricing plan, even as an account imposes an increasing burden to the cost of operations, it is making a declining contribution to revenues.

Mercy Hospital's rates for 24 hour a day service (with 150 answered calls included in the base rate), is $40.00. An ATSI member bureau, competing in the same area charges a base rate of $58.00, which includes only 50 answered calls. Overcalls are charged at $.35 each. A 150 call account, therefore, would pay $93.00 a month for service which Mercy provides for only $40.00.

Mercy's TAS operations are housed in the hospital's building facilities. No information is available on how or if the hospital is being compensated for the use of its facilities by the TAS operations.

HOLY REDEEMER HOSPITAL
Meadowbrook, Pennsylvania

Holy Redeemer charges a $75.00 a month rate, with 200 calls included in the base. A 200 call account at an ATSI member bureau in the same area would pay $93.00 per month.

The hospital TAS bureau reportedly pays its operators $7.25 per hour. The hospital, in addition, offers an extensive (and costly) package of additional benefits. Competing bureaus typically pay $3.75 to $5.00 an hour without the additional, costly benefits pacakage. Labor costs for the hospital are at least double: rates charged for service are 25% lower.

DANBURY HOSPITAL
Danbury, Connecticut

The clearest demonstration of a hospital ignoring its operating costs and pricing its service solely on the basis of what it takes to encourage doctors to leave a commercial TAS and become a customer of the hospital's TAS comes in papers filed in a case in the state of Connecticut (Rotophone, Inc., et.al. versus Danbury Hospital, No. CV83-0282515, Superior Court, the Judicial District of Danbury). In the hospital's response to interrogatories, Danbury Hospital maintained it charged different customers of its TAS operations different rates because the hospital "intended to charge each physician... rates comparable to those being charged by their previous answering service." In fact, it appears to have been the practice of the hospital to determine what each physician was being charged by their TAS, then offer them service for less. (See paragraphs 15-17 of Danbury Hospital's (defendants) supplemental response to interrogatories in the above referenced case...included here as Attachment III).

ST. JOHN'S HOSPITAL
Anderson, Indiana

St. John's Hospital's TAS operatíons offers service at a flat rate of $30.00 per month. Anderson is a very small community: there are, nonetheless, at least two private TAS bureaus offering service to the medical community in that area. According to these bureaus, even if St. John's was providing service to every doctor that is not already a customer of a local TAS, it would be serving no more than 90 doctors. At $30.00 per month per doctor, at least 100 doctors are needed to recover the just the cost of having a single operator on duty, twenty four hours a day, if operators are paid $4.00 per hour.* (As a practical matter, a TAS cannot function with only one operator on duty at a time, particularly during certain regular, peak-traffic hours).

TRINITY MEDICAL CENTER
Minot, North Dakota

Trinity offers service to a customer base of approximately 20 clients. It pays its operators $5.50 an hour, and charges a flat rate of $25.00 per month. Calculated in the same way as in the last example, the hospital faces a cost of $4,092.00 in wages alone in order to have one operator on duty on a 24 hour a day basis. The rates are clearly not compensatory.

24 hour a day answering service available in this market area from non-hospital affiliated TAS costs $81.00 per month, with 80 calls included in the base rate.

METHODIST HOSPITAL
BISHOP CLARKSON MEMORIAL HOSPITAL
ST. JOSEPH HOSPITAL
Omaha, Nebraska

No fewer than three hospitals in the Omaha area operate telephone answering services. Methodist charges a flat rate of up to $30.00 per month. Bishop Clarkson Memorial and St. Joseph's charge $31.00 per month. All charge a flat rate, regardless of call volume.

By comparison, a local bureau charges $43.00 per month for up to 75 calls, with an overcall charge of $.40 for each additional call.

The effect on revenue of a pricing plan which includes unlimited calls on revenue flow can be illustrated by this bureau's experience: In the past 12 months, the private bureau has lost 25 accounts to hospital TAS operations. Those 25 accounts represented, on average, $2,121.35 a month in revenue for the TAS. The maximum revenue those same accounts are generating for the hospital is $775.00. (25 x $31.00 per month).

This is not an exhaustive list of the hospitals that we are aware of who are competing with private answering bureaus. Hopefully, it is sufficient to demonstrate that hospital TAS are charging significantly lower rates, although they face generally higher labor costs (again, with labor being the single most important factor in determining an answering bureau's cost of doing business). There is significant evidence of hospitals competing with commercial, tax paying entities at prices which are clearly based on market capturing motives and which do not cover their actual costs of providing service.

Admittedly, TAS bureaus have experienced challenges from start-up, commercial TAS operations which similarly, underprice service in an attempt to gain market share. Such operations, however, must eventually raise prices to recover cost (and a profit) or they eventually go out of business.

Hospital-run TAS operations, however, in many cases appear immune to the realities of the marketplace. Although generating revenues at a level well below their cost of doing business, they continue to operate, and to lure customers away from commercial TAS operations.

This, in many cases, jeopardizes the viability of the commercial TAS. In every case, it reduces the volume of revenues upon which taxes are paid.

We urge the Congress to seriously evaluate the extent to which tax exempt organizations, such as hospitals, are permitted to engage in commercial activities.

(An attachment to the statement is maintained in subcommittee files.)

---

*Assume the messaging operation schedules its staff in such a way that it has one operator on duty, 24 hours a day, but no operator working hours which would require overtime charges.

A thirty one day month totals 744 hours. At $4.00 an hour, wages would total $2,976.00 a month to staff this operation. At $30.00 per account, 100 accounts are needed to generate revenues to fully recover this cost alone.

Social Security taxes and other employee benefit costs are not reflected in this figure.

Mr. **Flippo**. I thank each of you for your testimony.

There are two things that I would request of each of you, if you don't mind. Each of you have cited examples in your view of abuses. I wish that you would furnish the committee with the evidence to support that to the extent it is possible for you to do so.

As the chairman said earlier, we need hard evidence on the charges. For instance, Mr. Mayer, you indicated space and capital and personnel and several other areas. To the extent that you could document that it would be very helpful to the committee.

The second thing I would like to ask you to do is to examine very carefully Treasury recommendations to this committee as to how they would suggest we approach this problem and give us your views in writing specifically on Treasury's recommendations. That would be very helpful to us as well.

[The following letters were subsequently received:]

July 14, 1987

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Re: Unrelated Business Income Tax
Testimony of June 26, 1987

Dear Mr. Leonard:

The chair requested that I respond to the proposals made by the Treasury Department in its testimony of June 22, and that I provide specific details or examples of unfair competition from hospitals.

Upon review of the proposals of the Treasury Department I find that they do not address my specific concern. Per my testimony I related that for-profit DME companies owned by non-profit holding companies are unfairly utilizing the resources of the non-profit hospital.

To ensure the enforcement of proper cost accounting by the non-profit group would be highly improbable. And since the non-profit group has already set up the DME subsidiary as a for-profit company, they are admitting that a substantial relationship to the tax-exempt purpose of the non-profit does not exist. Further, it should be stated that the products and services of a DME company (for-profit) have been commercially available for decades. As of 1987 there are approximately 2,500 DME Provider numbers assigned to various institutions throughout Michigan.

Therefore, I recommend that the cross-utilization of any resources or assets (tangible or intangible) between non-profit and for-profit companies within the same organizational structure be prohibited.

The most visible example of resource support rendered to for-profit subsidiaries of a non-profit group is the initial capitalization required to start a for-profit company. All hospitals within Michigan are non-profit and all have transferred millions of dollars of non-profit assets to commercial, for-profit ventures. These assets are a result of profits (residuals) from the non-profit hospital. They are profits generated by excess patient charges, favorable tax legislation, public and private grants, low-interest loans and held in "public trust" for the fulfillment of the original tax-exempt purpose of the non-profit hospital.

I was not able to capitalize my company in the above manner. During the early 1980's I was paying interest charges in excess of 20% on loans guaranteed by my personal property. This is unfair. Therefore, my second recommendation is that the residuals or surplus funds generated by the activities of a non-profit hospital must remain within that entity to serve its original tax-exempt purpose, or to lower the fees for health care.

With regards to my testimony I cannot, without legal investigatory powers, give you the hard evidence you require. The non-profits and for-profits know what I testified to is the truth. Almost all hospital management personnel I have talked to acknowledge unfair competition. Their attitude is one of arrogance and impunity when they say, "Stop me, if you can."

The Articles of Incorporation for some for-profit companies can be provided for you. Within them you can track the parent organizations and the amount of non-profit assets transferred for capitalization purposes.

In summary, I do not challenge the original tax-exempt purpose of a non-profit hospital. I do challenge the new penchant for profits typified by the tremendous growth of for-profit, commercial companies owned by hospitals.

I look forward to your continued investigation into this matter.

Sincerely,

Robert Mayer/DSK

Robert Mayer
President
Michigan DME Crisis Committee
Director, NASBAHUC

VirginiaHomeMedical

July 15, 1987

Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Leonard,

Per your memorandum of July 1, 1987 I am enclosing the corrected copy of my testimony. I am including my comments relative to the Committee's request for input from my panel regarding the Treasury Department's recommendations. Specific to the Committee's request for *hard* evidence, I have been *completely* unsuccessful in obtaining a copy of the newsletter from the hospital regarding the transfer of donated funds to start a home infant monitoring program which I referenced in my testimony. I am curious as to whether or not the Committee would even be successful. Additionally, as evidence, as to exactly how a "captive referral" system works I am enclosing two examples. First, is a letter we received from two staff physicians of our non-profit hospital, which is clear in its intent. I might also add that they are, to our knowledge, medical directors of the hospital owned home oxygen company. Secondly, is a letter written by a physician to the head of the Physical Therapy Department of this hospital which clearly states that his orders regarding a referral were not followed and that the patient was directed to the hospital owned medical equipment company. These are only a *few* of the examples of the kind of tactics hospitals use to exercise their "captive referral" advantage.

Finally, I would like to address the Committee's request for input on the Treasury's recommendations point by point:

1) I believe the need for a review and correction of reporting procedures of UBIT and the enforcement is long past due.
2) I disagree strongly where this recommendation indicates that exemptions on sales of donated property are operating properly. This is what can act as the "seed" money for commercial enterprises of non-profits. The "substantially related" standard of business operations should be investigated by the Committee in regards to whether or not the use of the donated funds should even be allowed for use in unrelated business activities.
3) I am somewhat unfamiliar with the rules regarding computation of the UBIT or the "fragmentation rule", but do not perceive any major issues with increasing the deduction from $1,000.00 to $5,000.00.
4) This recommendation is an appropriate starting point to addressing small business's concerns regarding the multi-layered, hybred non-profit organizations which I focused on in my testimony. I would offer that any charitable donation made by

☑ 12436 Warwick Boulevard, Newport News, VA • Peninsula: 596-9600 • Williamsburg: 877-9600
☐ 3874 North Military Highway, Norfolk, VA 23518 • 857-0444
☐ 3933 Poplar Hill Road, Chesapeake, VA 23321 • 484-7300

a for-profit subsidiary should be deemed as taxable income to the non-profit parent receiving the donation. I would also offer that the focus on aggregating the activities of these hybred-organizations should focus on structure and requiring a high degree of accountability regarding sharing of cost, equipment and plant between non-profit parents and their for-profit subsidiaries.

5) Regarding passive income exemptions, I believe traditional investment vehicles, such as, stocks, bonds or mutual funds should have their income exempt. Small business is most concerned with the common practice of non-profits taking funds which they might otherwise invest passively and use them instead to either acquire or finance commercial enterprises. The continued exemption here would help to increase the incentive for non-profits to invest excess funds passively versus in competing commercial activities.

6) I agree strongly with this recommendation due to testimony I have reviewed by the small business sector representing independent laboratories. The public subsidiary universities currently enjoy when it comes to competing for private industry proprietary research is both unfair and anti-competitive.

7) Again, this recommendation (like #4) deals with what I feel is the fundamental starting point in the evaluation of UBIT. That is, the organizational structure(s) of tax-exempt organizations must be evaluated for their contributions to the problem of defining and tracking UBIT. The Committee needs to be aware of the current structural advantages and how any recommendations they make will effect the ability of structural changes to avoid or nullify those recommendations.

I thank you for the opportunity to work with the Committee and pledge my support and continued efforts toward helping the Committee achieve it's goals.

Sincerely yours,

Thomas E. Inman, II
President

Enclosures
TEI:jsb

GENERAL SURGERY, Ltd.
JOHN A, CROSS, M.D.
14 Bruton Avenue
Newport News, Virginia 23601

Telephone: 595-7669

MAR 1986
RECEIVED

March 26, 1986

Betty Gast
Chief of Physical Therapy
J. Clyde Morris Boulevard
Newport News, Virginia 23601

Dear Ms. Gast:

I am somewhat concerned about an instance that happened recently, and I have discussed this with Wayne McMasters on 3/25/86. I saw a Mrs. Tevis Taylor on 3/20/86 and sent her over to Physical Therapy to be fitted for a TENS Unit. At that time on a separate piece of paper I gave her a prescription to obtain the unit from Virginia Home Medical and discussed with Mrs. Taylor that she would be getting a unit from them. I then sent her to Physical Therapy and Wayne McMasters tells me that it was inconvenient to get a unit from Virginia Home Medical and therefore, he obtained a unit from MedEquip Center. I first heard of this when I received a letter from MedEquip Center wanting me to state the medical necessity of the equipment for Medicare billing. I called the Director at MedEquip Center and instructed him that I was unhappy with this situation. Mrs. Taylor,who is an old old patient of mine and who has had a great deal of problems including back problems, multiple back surgeries, bilateral mastectomies, etc., was quite upset with the situation, and I think she has simply been caught up in the middle of a power struggle over the marketing of TENS Units.

She tells me that she gave them the prescription for Virginia Home Medical, and the person she talked to in Physical Therapy said they did not deal with them but would obtain a unit which they did in approximately fifteen minutes.

Please instruct me as how we should do this. Maybe I do not order enough TENS Units to know what is going on. Should I have the patient obtain rental or purchase of the TENS Unit before they come to the hospital? It is my understanding that the MedEquip TENS Unit is approximately $85.00 a month rental according to the patient. Please advise me as to who gives the best prices and the best service? If there is a difference in service or a difference in price, then I want to use the most competitive supplier whether it be MedEquip Center, Virginia Home Medical or some other company of your choosing.

I simply was concerned that I gave the patient a prescription for a specified supplier, never having delt with MedEquip Center knowingly nor even have heard of them before, and received their equipment for my patient. I am upset that my patient has been caught in the middle of this, and I am getting the impression from what my patient tells me and what information I am getting from other persons, is not correct.

Please advise me as to the best way of handling this. I would appreciate your thoughts and advice.

Kindest regards,

John A. Cross, Jr., M.D.

JACjr/gkp
3/26/86

cc Virginia Home Medical
12436 Warwick Boulevard
Newport News, VA. 23606

cc MedEquip Center
658 J. Clyde Morris Blvd.
Newport News, VA. 23601

RIVERSIDE HOSPITAL

RECEIVED
MAY 1985

April 9, 1985

RE: Home Respiratory Equipment

Dear Home Respiratory Equipment Provider:

Due to the large number of patients now managed with out patient Respiratory Care Equipment, our office has received large numbers of forms for documentation for need of, Respiratory Care Equipment for 3rd party payers. These forms require review of office and hospital records, by our office personnel and final approval and signature by one of the physicians in our group. This involves a significant amount of time and expense to our office staff and also physician time. This, has in the past, been provided a free service to the provider of the Home Respiratory Equipment, but because of the increasing time and expense involved, we will be requiring a small fee to cover the overhead for preparation of these forms.

As of April 1, 1985 all requests for preparation of the above mentioned forms will have to be accompanied by a check for $10.00 made out to Peninsula Pulmonary Associates. We regret the necessity to institute this fee, but can no longer provide this service without some means to off set our costs.

~~Since~~ this service benefits primarily the Respiratory Equipment provider, and not the patient we feel this cost should not be passed on to the patient. We hope that this latter request will be honored for those patients we refer to you. If not, we will attempt to refer our patients to those companies who do not feel the need to pass this expense on to the patients themselves.

J. Clyde Morris Boulevard, Newport News, Virginia 23601 (804)599-2000

Page 2

Continued:

We appreciate your interest in our patients and the good service that you have provided them. We hope this small change will not put an undue fiscal burden on you.

Sincerely,

James O. Shaw Jr., M.D., FCCP

Laurie W. Moore Jr

Laurie W. Moore Jr., M.D.

Peninsula Pulmonary Associates

JOS:ckm

INTERNATIONAL TAXICAB ASSOCIATION
3849 Farragut Avenue • Kensington, Maryland 20895 • Telephone (301) 946-5700

July 9, 1987

RECEIVED
JUL 9 1987
Ways and Means
Subcommittee on Oversight

The Honorable J.J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On behalf of the member companies of the International Taxicab Association, I wish to thank you for the opportunity to testify before your Subcommittee on June 26, 1987, concerning the unfair competition between tax-exempt organizations and taxable for-profit businesses. This letter responds to your requests and that we comment on the recommendations made by the Treasury Department, and that we provide your Subcommittee with examples of that unfair competition.

Treasury Department Recommendations

At the outset, let me note that because our members are typically small businessmen engaged in providing transportation services, ITA does not have comments on all of the Treasury Department's recommendations.

I should also point out that Treasury's proposals only peripherally address the central concern of ITA: that the provision of transportation services, even if limited to the elderly and handicapped, is not necessarily a charitable or otherwise exempt activity, nor is it necessarily "related" to charitable or otherwise exempt purposes that may characterize various exempt organizations that compete with taxicab and paratransit companies.

Treasury Recommendation No. 1

> With respect to business activities of exempt organizations, the Treasury Department believes the current standard of a substantial relationship to an organization's exempt purpose has conceptual merit as the basis for granting exemption from tax. We are concerned, however, with administrative and interpretative problems this standard has created. Although we do not propose changes in the "substantially related" standard, we do recommend more detailed reporting as a means of improving enforcement and compliance and of providing a basis for further review of the adequacy of the standard.

ITA Comment: ITA generally agrees that the "substantial relationship" test has conceptual merit as the basis for granting exemption from tax. It achieves the purpose of the tax, yet is flexible enough to be applicable to the changing and innovative methods used by exempt organizations to produce revenue. ITA further agrees that more detailed reporting will provide the information necessary to improve enforcement and compliance.

However, ITA is also concerned that insufficient attention has been given by the Subcommittee and witnesses to the purposes to which the business activity must be substantially related. The successful administration and enforcement of the "substantial relationship" test depends not only on correctly analyzing the relationship, but also on the exempt organization having an exempt purpose to be accomplished in the first place. ITA therefore recommends that the Internal Revenue Service give more careful scrutiny to applications for exemption from entities that propose to provide transportation services, to ensure that the class of persons being served is not just "elderly and handicapped," but that the organization proposes to use objective measures of poverty to determine its clientele, and to ensure that the organization will depend on gifts, not governmental contracts, for its funding. Existence by means of government contracts is not the hallmark of a charitable organization, but a commercial one.

In this regard, we endorse Professor Hansmann's testimony that non-profit entities in service industries should be required to

> demonstrate that they provide a significant quantity of charitable services in the traditional sense of that term -- namely, free or below cost services for the poor, or uncompensated services that are clearly of broad benefit to the public at large.

* * * * *

Treasury Recommendation No. 3

> With respect to the computation of the tax on unrelated business income, we suggest that the rules for allocation of expenses be clarified to reflect the appropriate relationship between an organization's exempt functions and unrelated activities. In addition, we support retention of the "fragmentation rule" and an increase in the specific deduction from unrelated business income from $1,000 to $5,000.

ITA Comment: We agree that expense allocations should reflect generally accepted accounting principles, and that inflation since 1950 and the adminstrative burdens for small organizations and the IRS justify increasing the specific deduction to $5,000.

* * * * *

Treasury Recommendation No. 5

> With respect to passive investment income, we suggest that such income should continue to be exempt in the case of public charities, but should be taxable to social welfare organizations unless permanently set aside for charitable purposes. The treatment of passive income of labor unions and trade associations requires further study. In addition, we suggest that the exclusion for royalties should be narrowed to prevent avoidance of the tax on unrelated business income in certain circumstances.

ITA Comment: ITA believes that taxing the passive income of trade associations would not result in any significant increase in Federal tax revenues. Trade association activities presently funded by the amount of taxes that would be payable on investment income would be funded by increased, deductible, membership dues, leading to a corresponding reduction in tax revenue from association members.

While the definition of royalties may require some clarification, ITA does not believe that the policy underlying the unrelated business income tax justifies taxing royalties received by a trade association from licensing its name or trademarks.

Examples of Unfair Competition

During my testimony before your Subcommittee, I cited several examples of unfair competition between tax-exempt entities and taxicab or paratransit companies that are members of ITA. These examples are drawn from responses by ITA members to an informal survey sent by ITA to its members in April of this year. The survey was sent to ITA's 531 U.S. members; 121 responses were received from taxicab and paratransit companies providing urban, suburban, and rural service, a 22.7 percent response rate. Of those 121 respondents, 117 (97 percent) face competition from as many as six tax-exempt transportation providers funded by government contracts and commercial fares, not by charitable contributions. Indeed, ITA is unaware of any tax-exempt transportation provider that is funded principally, or even significantly, by charitable contributions.

The following examples illustrate the variety of ways in which tax-exempt organizations unfairly compete with taxicab and paratransit operators.

Example 1:

In the Central Valley community of Hanford, California, Hanford Taxi has seen its revenues drop by $1,500 per month since a government-operated tax-exempt provider, King Area Rural Transit, which transformed its operations from a fixed-route bus system to a "demand-response" service that is no different than calling a taxicab. King Area Rural Transit provides transportation to anyone who is elderly or handicapped, regardless of whether they are poor, as well as the poor. These groups comprised about 80 percent of Hanford Taxi's daytime ridership. The provision of transportation to non-charitable classes of individuals is clearly neither an essential governmental function nor a charitable one, and the gross revenues of King Area Rural Transit should be treated as gross income and subject to income tax.

Example 2

In nearby Madera, also in the Central Valley of California, the Madera Cab Company has lost 60 percent of its gross revenues to the City of Madera Dial-A-Ride. This tax-exempt transportation not only serves the elderly and handicapped (who may pay with tickets issued by the City of Madera), but will also transport anyone who will pay a cash fare.

In addition, although a local ordinance requires taxicab companies to undergo a police investigation and a public hearing on the issue of whether there is a need for the additional service proposed, it appears that a certificate of conveyance was issued to the Dial-A-Ride company without the preliminary investigation and public hearing. While no illegality is necessarily present, the streamlined procedure does show that a tax-exempt, non-profit provider receives substantial non-tax benefits, even though it has no exempt purpose.

As suggested by the facts in this example, the Subcommittee should note that many states grant various non-tax preferences and exemptions to tax-exempt transportation providers. These benefits only increase the ability of tax-exempt providers to compete unfairly with taxable providers. Not only are the tax-exempt providers relieved of the burdens of income taxation, but they also avoid the costs of, for example, complying with state licensing standards or purchasing liability insurance. In Massachusetts, tax-exempt organizations that already provide "social or rehabiliation" services may be granted a 10 percent preference on bids for government-funded transportation service contracts. This preference is available even though the transportation services would be entirely unrelated to the social or rehabilitation services already provided.

Example 3

In Fort Wayne, Indiana, the Public Service Commission of Indiana determined that the Allen County Council on the Aging, a §501(c)(3) organization, has operated transportation services for the elderly and handicapped in violation of Indiana's licensing and insurance laws. Operation of activities in violation of state law is clearly grounds for revocation of exempt status, Bob Jones University v. United States, 461 U.S. 574 (1983); Church of Scientology of California v. Commissioner, 83 T.C. 381 (1984), because substantial violations of state law vitiate any otherwise charitable purpose or activity.

Example 4

Another example of illegal operations by a tax-exempt transportation provider is the aptly named Rogue Valley Transporation District (RVTD) of Ashland, Oregon. The Urban Mass Transportation Administration (UMTA) has repeatedly found that RVTD has operated inter-city charter bus trips in violation of UMTA regulations governing the use of buses purchased with Federal funds.

Example 5

Transportation Resources, Inc. (TRI), a §501(c)(3) organization located in Columbia, Ohio, advertises in the Yellow Pages that it provides "charters, field trips, all types of group transportation" at "economical rates." TRI competes commercially with taxable taxi and paratransit companies. In 1986, TRI won a county contract to transport elderly and handicapped persons by underbidding an ITA member company by 11.5 percent.

Example 6

In LaCrosse, Wisconsin, Topp's Taxis and the LaCrosse Cab Company, both operated by Top Hat Partners, have faced unfair competition from Bethany Lutheran Homes, a tax-exempt nursing and retirement home that has expanded its transportation services for its residents through Federal and state grants to transport non-resident elderly and handicapped persons. Because of its tax-exempt status, Bethany Lutheran Homes has been able to obtain county contracts to provide these services even though Top Hat Partners has consistently offered to provide more hours of service for less money. Earlier this year, Bethany Lutheran Homes recently withdrew a request for an UMTA-funded state grant to purchase vans when the Wisconsin Department of Transportation indicated that Bethany would be required to subcontract operation of the vans to Top Hat Partners.

Mr. Chairman, these examples clearly demonstrate that taxpaying taxi and paratransit companies are losing business to tax-exempt organizations whose only or principal activity is the provision of commercial transportation services, paid for either by government contract (not a gift or even a grant) or by fares paid by passengers. These organizations take advantage of their tax-exempt status to underbid taxable businesses for contracts, and to avoid costs imposed by state licensing and insurance laws from which they may be exempt. In two examples, the arrogance of these "charitable" organizations led them to operate in violation of Federal or state law.

The International Taxicab Association urges the Congress to clearly establish the law, and the Treasury Department and the Internal Revenue Service to faithfully interpret and administer the laws enacted by Congress. ITA does not believe that the provision of transportation services to the elderly and handicapped is inherently an exempt purpose within the scope of §501(c)(3) or §501(c)(4). Accordingly, we urge the IRS not to recognize as tax-exempt those organizations that do not restrict their service to the poor, or that do not depend on gifts and grants (as opposed to government contracts) to maintain their operations.

Again, Mr. Chairman, I thank you for the opportunity to testify before the Subcommittee, and to provide you with this additional information. Should you or your staff have any further questions about this matter, please do not hesitate to contact our Executive Vice President, Mr. Alfred B. LaGasse III, at 3849 Farragut Avenue, Kensington, Maryland 20895, (301) 946-5700.

Yours very truly,

Jerilyn Nettnin

(Mrs.) Jerilyn Nettnin

Mr. FLIPPO. Mr. Schulze?

Mr. SCHULZE. Thank you, Mr. Chairman.

First, let me state that I agree wholeheartedly with what you have just requested. It would be most helpful. I would like to thank this panel.

I have only one question for you and that is which is more devastating as far as the competition to you, the halo effect or the ability to under price services of products? I would like each of you to respond.

Mr. GOLDEN. For the TAS industry it is the pricing issue.

Mrs. NETTNIN. I believe that the price effect would be harmful to us. There are certain organizations that undercut our industry by up to 20 percent from what we bid on certain transportation service.

Mr. SCHULZE. Price——

Mrs. NETTNIN. Yes.

Mr. SCHULZE. I noticed in your testimony you said something about looking into the salaries paid or remuneration paid in some of these instances, that you feel that it might be higher than comparable salaries in the private sector, is that right?

Mrs. NETTNIN. I don't believe I said that.

Mr. SCHULZE. I guess what I was looking at was in your outline you said to ensure that exempt transportation providers are not paying unreasonably compensation. You didn't mean that you felt there were unreasonably high salaries being paid?

Mrs. NETTNIN. To our workers, are you saying?

Mr. SCHULZE. To the others?

Mrs. NETTNIN. I don't know that, sir.

Mr. SCHULZE. Mr. Inman?

Mr. INMAN. I would say that pricing is the No. 1 consideration. Any businessman worth his salt can beat the halo effect on quality, service and product.

Mr. MAYER. Of the two options that you gave me I have a hard time guessing between the two or making a choice between the two, but according to my testimony I listed a number of different advantages that a nonprofit hospital has.

Captive referrals, I believe, are the most important because they choke off the marketplace for us. Of the two options you gave, I would have to choose the halo effect.

Mr. SCHULZE. I see where in your instance that would be more important.

Thank you.

Mr. FLIPPO. Mr. Anthony?

Mr. ANTHONY. Thank you, Mr. Chairman.

Mr. Chairman, I think after having heard the panel yesterday and hearing this panel, there are some conflicting statistics floating around. I would like to probe this panel a bit to see if you could help clarify.

In looking back, I find that of the 850,000 tax-exempt organizations, only 27,000 actually filed a 990-T in 1986. That is less than 4 percent, which could lead to two conclusions, one, that there are a lot of income-producing related activities going unreported and, therefore, unaudited and unchecked, or it is not as big a problem as some may make it out to be.

Do you have any thoughts on that?

Mrs. NETTNIN. The ITA has conducted a survey of its 531 U.S. members. From that group 121 responded and we found that of the 121, 97 percent face competition from as many as 16 tax-exempt transportation providers. We do have those surveys, and we can make them available to the committee.

Mr. ANTHONY. I wish you would do that, because I also know that the delegates to the White House Conference on Small Business, listed unfair competition as the No. 3 problem. Yet, I have in my file a study that was done in 1986 by William J. Dennis, Jr., published by the Institute for Enterprise Advancement; it is entitled: "Small Business Problems and Priorities," and you have to go all the way down the list to No. 70 under this study before you find competition from government or nonprofit organizations listed.

Yet No. 1 is cost of health insurance and cost and availability of liability insurance.

I think the correlation there is true, because in this White House Conference on Small Business, liability insurance and the cost of availability was listed No. 1, so you have got a pretty good correlation on the No. 1 issue because here it ranks No. 2, right behind the cost of health insurance.

Do you have any additional studies or subareas within your organizations that would tend to dispute that?

Mr. INMAN. I am not aware of any, but to answer your first question, I would like to respond to that in unscientific way.

In 1985, $300 billion worth of revenue was generated by nonprofits in the country.

Mr. ANTHONY. Would you repeat that number?

Mr. INMAN. $300 billion was generated by nonprofits in the country, total revenue, was $300 billion, or 8 or 9 percent of GNP.

The point I want to make is that, as a result of these hearings, if we can help you to get a better idea on potentially what basic percentage you might be able to ascertain might be unrelated business income. I ran some quick figures a few months ago, and if just 10 percent of that $300 billion was unrelated and should have been taxed, or if the organizational structures, if the government would have been served better if it had been under private ownership business doing that $30 billion, at the minimum tax bracket of 28 percent that would have meant $8.4 billion into the Federal Treasury in 1985, and it is growing every year, and I think that is substantial.

But scientifically I don't know if it is 10 percent, 1 percent, or 50 percent.

Mr. ANTHONY. We are going to hold hearings later in July, we are going to be looking for $20 billion to try to balance this.

Mr. INMAN. Hopefully, we can find 40 percent of that for you.

Mr. MAYER. I would like to address both your questions very briefly, if I could?

On the second one, I am not familiar with the study that you have in front of you so I can't comment much on that. However, on the first question, I think one of the difficulties is that we have a lack of hard data on this particular phenomenon right now.

Just recently the IRS announced a program where they are going to be auditing the records of over 3,000 nonprofit entities for the purpose of accumulating some data on this point, which is supposed to be complete, I think, June of 1988, so, hopefully, by that time we will have additional data.

This is a common problem.

Mr. **Anthony**. I will give you an additional fact that you might use in your next speech around the country.

Mr. **Mayer**. All right.

Mr. **Anthony**. Of some $87 million that has been brought in as additional taxes as a result of audits, 50 percent of it came from just two organizations, as I understand it.

Mr. **Mayer**. I will use that.

Mr. **Anthony**. I think the same IRS audit represents that.

Mr. **Inman**. Are you referencing UBIT audits?

Mr. **Anthony**. Yes. I think that was one of the facts that drove this committee to hold these hearings. What disturbs me, I come from a small State. My particular district is very rural and you have for-profits sitting there in these little towns and you only have a certain amount of public civic-minded individuals. You only have a certain base of people who are going to go out and try to get these little towns going and growing.

So what I have found is that the people who serve on the Board of Directors of the nonprofits, be they hospitals, YWCA's, you name it, they also have businesses right across the street. So I am running into an interesting set of circumstances here.

On the one hand, they may feel the competition from the price, and, on the other hand, they know that these tasks of nonprofits are providing some community services. I guess my question to you is, inasmuch as you responded price, price, price, because price, price, price, relates to profit, profit, profit, if we toughen the rules such that these unrelated businesses would evaporate so that the private sector would take them over, would the private sector keep those prices low enough so that the poor and the near poor would be able to benefit from those services, because that is one of the stated purposes of the tax exempts?

Could you respond philosophically to the thrust of that question?

Mr. **Inman**. Let me respond to that, Mr. Anthony.

Mr. **Anthony**. Each one of you will have an opportunity.

Mr. **Inman**. Our company gives indigent care and we deal with medically indigent patients on a daily basis. We are not required to do that. We do that as a service to the community. Because of the Rolaids I eat, I don't want to know how much we give. It disturbs me when we go into the records of the State of Virginia and pull the State wealth plan and look at hospitals that are doing $70-plus million in total revenues in a year, showing a net income of $6.2 million, and in giving $30,000 worth of indigent care. I think that is an area that the small business man has a real problem with.

We have cases in Virginia, and other States no doubt do also, in response to your rural question; that is valued in a very small community that tend to be a little more autonomous in its economy. The control the board has over the hospital's activities tend to be much tighter in a large metropolitan area where the hospital may be part of a $150 million organization of which only the holding company may generate $150 million in income every year, but the hospital may only generate a portion of that and it is these hybrid organizations that can cross feed on each other. We have sort of termed it "commercial nepotism", because they are such autonomous structures and tend to go into areas with for-profit ventures as you heard from the first panel, laundry services, telephone answering, durable medical equipment, taxicabs.

Mr. ANTHONY. It sounded like the Fortune 500 when you start saying all they are involved in.

Mr. INMAN. Exactly, and they tend to go into areas with minimal business expense.

Mr. ANTHONY. Are you saying that this committee ought to totally prohibit them from going into those activities, every one of those activities?

Mr. INMAN. No. I think that the awareness of the committee needs to be brought up to the reality of what is going on and the motivations because with the prospective payment system, hospitals have had to make dramatic adjustments in the way they do business, and think about business. One of the areas they have said that they are going to use to replace income is in the private sector.

Mr. ANTHONY. You are saying since we passed prospective payment in 1985 and we know there have been dramatic changes in health care since then, that is when the activities really started in earnest?

Mr. INMAN. Yes, sir, but I believe that the structural changes began to occur in the early 1980's in anticipation of prospective payments, so areas could be removed so costs could remain as high as possible.

Mr. ANTHONY. But in the marketplace dramatically since 1985?

Mr. MAYER. Early 1980's.

Mrs. NETTNIN. Mr. Anthony, I believe that when you talked about competition, there is competition within the private sector. In transportation, you could use a taxi service, a para transit service, a bus service, and so forth. There is and there would continue to be competition to get the lowest price.

The International Taxicab Association feels that nonprofits should be taxed on the services where they are competing with the private sector. We believe that many nonprofits are necessary, but if they are providing a service that a private sector company can do then they should be taxed on that service.

Mr. ANTHONY. Mr. Chairman, I would like to close by telling a personal story in my hometown. A medicare patient needs to go to the hospital to get a series of treatments. He can be transported in a taxicab or private car as easily as a costly ambulance. The rules are such that they were not reimbursed if they went by taxicab, which would cost about a buck and a half, so they had to send an ambulance for this person to the tune of $155.

So we have lots of problems. Mr. Chairman, I have got lots of questions and curiosity about this whole subject, but I know our time is short, so I will yield at this point.

Mr. FLIPPO [presiding]. Mr. Jacobs. Mr. Dorgan.

Mr. DORGAN. Mr. Chairman, let me tell the panel that I have been at several of the meetings during much of your testimony and for that reason will not ask questions. I have been reviewing your testimony and find it interesting. The health care area is special and unique, and I happen to come from one of those regions of the country that is sparsely populated, generally smaller communities in which for health care, the not-for-profit hospital, is central to the health care needs of the citizens.

What we are trying to decide throughout these hearings is, are changes necessary in this whole area and if so, what should those changes be? My own inclination is not to want to see wholesale changes that are not well thought out. As I indicated yesterday, we are dealing with an area of judgment on the question of what is substantially related. That is not like measuring a dollar of income.

If we make a change because we think that some folks are going over the line and the lines are not clear, and because it is unfair to the private sector, I want to make certain that we are very, very careful in understanding exactly what the consequences of those changes will be. It will be very important to many communities in this country.

So I will forego questions, but I want to thank you for appearing and say that having read it, I think it is interesting testimony and useful for the information of this committee. Thank you, Mr. Chairman.

Mr. Flippo. Thank you, Mr. Dorgan. I want to thank our panelists for being here today.

Our third panel of the morning, if our panelists would come to the witness table, we have Mr. Jack Owen, the executive vice president, and John Leech, chairman of the board of the American Hospital Association. We are pleased to have Sister Bernice Coreil, member of the board of trustees of the Catholic Health Association, Merlin DuVal, president and chief executive officer of the American Healthcare Institute, William Lehrfeld, counsel for the Shriners Hospitals for Crippled Children and J. David Seay, vice president, secretary and counsel for the United Hospital Fund of New York.

I thank all of you for coming and being with us today. We would like very much to hear your testimony. We would like to hear the testimony from all the witnesses before we go to committees. Sister, would you start us today?

STATEMENT OF SISTER BERNICE COREIL, MEMBER, BOARD OF TRUSTEES, CATHOLIC HEALTH ASSOCIATION

Sister Coreil. Thank you, Mr. Chairman. I thank you for the opportunity to present an oral statement to the subcommittee. We have already submitted a full written statement for the record. I am Sister Bernice Coreil, provincial administrator of the West Central Province of the Daughters of Charity. Our province sponsors 10 catholic health care institutions, including two hospitals in Austin, Texas.

Nationally, the Daughters of Charity sponsor 45 health care institutions. I am testifying on behalf of the Catholic Health Association on whose board I serve. CHA's nationwide members include over 900 Catholic hospitals and long-term care facilities.

I would like to focus my remarks on a few key points for your consideration as you examine the activities of not-for-profit hospitals in light of the current law.

One, the first concept I want to stress is balance. Given the predominant role which not-for-profit, nonprofit governmental hospitals play in the delivery of our nation's health care services, a critical human and societal need, I urge that any potential tax policy changes be balanced by consideration of the health policy implications.

This sector represents 71 percent of all community hospital beds—versus 10 percent for the for-profits and 19 percent for the public hospitals—and provides 73 percent of all hospital unsponsored care—versus 8 percent for the for-profits—plus the bulk of the community services, medical research and education.

Two, the focus of your hearings is unrelated business income. However, the vast majority of the activities and the revenues of Catholic not-for-profit health providers are related to our health care mission and our exempt purpose. That mission is the same today as it has been since 1727 when the first Catholic hospital opened in America, the promotion of health, and not simply acute hospital care. Our centuries old tradition of responding to those in need—the ill, the dying, the homeless and the poor—wherever they are and whatever their needs, has resulted in not only the development of modern, full service acute care hospitals, but also intermediate and long-term care facilities, home health services as well as mobile vans to bring necessary services to shelters for the homeless and inner city and rural poor.

Three, our ministry must operate within the environment of the times, and of the Nation and communities we serve. The past decades in health care have been marked by revolutionary changes in medical technology, in the delivery of health care and especially in the financing of necessary services. In my 33 years in the health care ministry, first as a hospital business manager and then as an administrator, I have witnessed at least three eras.

First, the preinsurance era of the 1950s when health care was generally paid for by those who could pay, and their payments, along with charitable contributions and volunteerism, helped cross-subsidize those who could not.

Second, the insurance expansion era of the 1960s and 1970s which resulted from the development of health insurance, Medicare and Medicaid, access to health care increased and reimbursement to providers was stabilized. Ultimately we saw the emergence of the investor-owned hospital chains.

Third, the current health-care-in-revolution period as government, insurers, consumers, and providers of health care struggle to cope with the cost crisis. Today we must meet our mission in the midst of government-encouraged competition, reduced reimbursement and shrinking charitable contributions.

Fourth, a snapshot of Catholic health care today reveals a continued primary focus on acute care hospital services coupled with an evolving range of nonacute care activities designed to respond to changing community health needs—for example, the AIDS crisis—in a changing environment, reduce our costs and/or increase our revenues so as to pay for other necessary health services.

I want to stress, however, that most of our non-acute-care activities are related to our exempt purpose and are not subject to the unrelated business income tax. In fact, looking at my province's seven hospitals, with nearly 2,900 beds and $369 million in net operating revenues, I can tell you that we have no unrelated business activity income that is subject to UBIT.

Our major source of unrelated business income which comes under the UBIT exemptions is interest on investments, which is passive income, and to a much lesser extent contributions and gifts. In summary, we believe that a very small portion of the activities and revenues of Catholic health care providers are unrelated. We acknowledge the lack of data in this area and the need for further study.

We look forward to the results of the IRS studies and the TCMP as a means to shed light on the area that so far appears to contain a lot of heat and anecdote. CHA is ready to work with the subcommittee and its staff to continue this examination. We join with the comments of others who have urged that you move deliberately and with full information.

Thank you very much.

[The statement of Sister Coreil follows:]

Statement of Sister Bernice Coreil, Catholic Health Association

I. Introduction

I am Sister Bernice Coreil, Provincial Administrator of the West Central Province of the Daughters of Charity of St. Vincent de Paul. I am testifying on behalf of the Catholic Health Association of the United States, whose nationwide membership includes over 900 acute and long-term care health facilities sponsored by Catholic religious congregations and dioceses. I am a member of the Board of the Daughters of Charity National Health System, the nation's largest not-for-profit health care provider.

The Subcommittee's examination of the policy considerations underlying the appropriate tax treatment of "income-producing" activities of tax-exempt organizations, the impact of present-law rules on both tax-exempt organizations and for-profit businesses, as well as IRS application of, and taxpayer compliance with, the law are both appropriate and important inquiries. This is especially true in the case of not-for-profit health care providers because of the veritable revolution that has occurred in our nation's health care delivery system since the 1950 enactment of the unrelated business income tax (UBIT) law.

The private, not-for-profit hospital is the predominant sector of our nation's health care delivery system, in terms of numbers of hospitals and hospital beds, and in terms of its provision of the bulk of community health services, uncompensated care, and hospital based medical education and research. Therefore, any change in the tax laws affecting our "income-producing" activities would have far-reaching consequences for the nation's entire health care delivery system. Consequently, it is essential that the Subcommittee examine UBIT-related questions in the context of a clear understanding of the special health care mission of the voluntary, not-for-profit health care provider and the increasingly complex and challenging environment in which we must carry out that mission.

The Subcommittee especially needs to appreciate that our mission and our exempt purpose are the promotion of health, broadly understood, not just acute hospital care. Our Catholic institutions have a rich, centuries-old tradition of providing a wide range of health care services according to community needs, medical state-of-the-art, and the overall environment of the time. Catholic health care initially served people in their homes, then in a variety of community institutions, of which the acute care hospital is a relatively recent phenomenon, and now again increasingly in the home and through other delivery methods. In other words, we have always taken health care where the community needs it, through the services permitted by medical technology, and in a manner that is in concert with the overall environment. Today, that environment is strongly influenced by federal government health policies and budget considerations.

Our testimony addresses the questions posed in the Subcommittee's press releases as part of a comprehensive explanation of the not-for-profit health care sector. This information is necessary in order for the members of the Subcommittee to appreciate all of the policy considerations underlying the appropriate tax treatment of the income-producing activities of not-for-profit health care providers -- not only the tax policy considerations, but also the important health policy considerations.

II. Profile of Not-For-Profit Health Care Activities

A. The Health Care Delivery System

To assess the impact on our nation's health care delivery system of any change in the tax treatment of not-for-profit health care providers, one must first understand the entire system and the predominant role that not-for-profit institutions play in it.

At the present time in this country, we have a wide variety of health care institutions conducting numerous health-related activities. For instance, in addition to acute care hospitals, there are other types of hospitals, such as specialty hospitals for specific illnesses, and other kinds of non-hospital health care institutions, such as nursing homes.

The largest and most visible part of the system, however, is the network of acute care hospitals. The short-term, acute care hospital system has three principle elements: 1) nongovernmental, not-for-profit hospitals; 2) governmental, state and local public hospitals; and 3) for-profit hospitals.

The non-hospital elements of the health care system also may be either not-for-profit, governmental, or for-profit institutions. This three-sector system reflects the American way of addressing social needs through a pluralistic system of health care providers. We believe that it works remarkably well in serving the needs of our citizens.

As noted above, however, not-for-profit acute care hospitals are the predominant health care institutions, generating revenues estimated at $102 billion in 1986. They also appear to be a focus of the Subcommittee in these hearings.

B. Not-For-Profit Health Care Providers

1. The Not-For-Profit Health Care Sector

While all three elements are integral to our nation's health care system, nongovernmental, not-for-profit hospitals are, and always have been, the mainstay of this system.

In 1985, 71 percent of all U.S. community hospital beds, and 58 percent of community hospitals, were not-for-profit. The next largest sector, public institutions, accounted for 19 percent of beds and 28 percent of hospitals. For-profit institutions accounted for 10 percent of beds and 14 percent of hospitals, and these are concentrated mostly in several states generally in the South and West.

Therefore, ninety percent of our nation's hospital capacity is outside the free market system, being either governmental or nongovernmental not-for-profit. This may reflect the fact that health care, one of the most basic human needs, is provided to persons often in a weakened, frightened, and dependent state, and who, therefore, are not the proverbial rational economic persons presumed able to protect themselves within the free market economy.

The health care needs of our citizens are substantial. An underlying philosophy of health care in the United States is that everyone has a right to adequate health care services. To a large extent, this national aspiration has been guaranteed neither by the action of the federal or state governments nor by the operation of the free market, but rather has been left to the best efforts of governmental and not-for-profit health care institutions.

Not-for-profit health care institutions have provided access to health care for those unable to pay by using community volunteers, soliciting community charitable donations, and cross-subsidizing those services provided at no fee, at a reduced fee, or otherwise inadequately reimbursed, with fees charged other patients for other services. Data from the American Hospital Association show that 73 percent of hospital uncompensated care is provided by non-governmental, not-for-profit hospitals. Of the remainder, 19 percent is provided by governmental, public hospitals, and 8 percent by for-profit hospitals.

The importance of the not-for-profit sector of our health care system, however, results not simply from our size or from our free and reduced-fee care to those unable to pay for necessary health care. It is also because we are the primary providers of health-related community services, and of hospital-based medical education and research.

The not-for-profit health care sector provides the bulk of community health care services, from community-wide health screening and health education programs, to programs that serve the special needs of specific populations within these communities. These include walk-in prenatal clinics in depressed areas, mobile clinics that allow us to take health care to the homeless, and numerous other outreach programs.

The not-for-profit health care sector provides the bulk of hospital-based medical education. In 1980, of the 329 major teaching hospitals in the nation, 248 were not-for-profit and the other 81 were public. The bulk of hospital-based medical research also is carried out in these not-for-profit teaching hospitals.

2. The Tax-Exempt Purpose of Not-For-Profit Health Care Providers

Several theories support the tax exemption for charitable organizations:

- Such organizations relieve government of the burden of meeting public needs and promote the general welfare._1/

- They advance the principles of pluralism, voluntarism, and individual initiative which promote a diversity of views and a variety of innovative solutions to problems, apply private wealth for public benefit, and provide a bulwark against over-reliance on big government while acting as a prod to government attention to social needs._2/

- They reflect the characteristically American historical fact that long before government became active in social programs, community social needs, including health care needs, were met through the voluntary, collaborative efforts of members of the community._3/

All of these rationales apply to health care providers. In the case of hospitals and their health care activities, the IRS has recognized that the "promotion of health...the relief of poverty and the advancement of education [are] purposes in the general law of charity that are deemed beneficial to the community." _4/ This is an apt description of the purposes of our Catholic health care Institutions.

These rationales apply not only to the provision of acute hospital care, they also apply broadly to the promotion of health, that is to all health care services. Therefore, when the Subcommittee examines our activities, and their relation to our exempt purpose, it is important to understand that our exempt purpose is broad, it includes not only acute and other hospital care, but also community health services, medical education and research, and other activities that promote health.

As times change, the specific activities conducted by not-for-profit health care providers to achieve their purpose also change. For example, Catholic health care is designed to be holistic in the sense that it deals with not only the physical but also the emotional and spiritual needs of the individual, and that it seeks to provide a continuum of care from the hospital to the home. In our earliest history, we provided care in the home. Later, we provided care in a variety of community institutions such as the early hostels for sick travelers, special homes for the aged and dying, institutions for persons with psychiatric problems, homes for unwed mothers, and facilities for the long-term, chronically ill.

The acute care hospital is a relatively recent setting for the delivery of health care. And as the needs of communities and the environment for providing health care services change, the acute care hospital is now being supplanted by other mechanisms: ambulatory diagnostic and surgery centers, walk-in and mobile clinics, a return to home health care with the associated need for durable medical equipment, and wellness and health promotion programs in the community. All of these activities together comprise the delivery of health care services.

The specific activities conducted in furtherance of our exempt purpose today also vary from one community to the next according to the specific health care needs of the specific populations being served. In some communities, the pressing health care need is the provision of free and reduced fee service to the medically indigent. Communities may also require the provision of socially important but inadequately reimbursed services such as burn treatment, neonatal intensive care, or drug or alcohol dependency treatment. Communities may also need medical research to solve local or regional health problems, such as Rocky Mountain Spotted Fever. The common factor in all of these situations is that the service is provided because the community needs it, *not* because meeting the need will produce a profit.

3. The Not-For-Profit and For-Profit Sectors

The focus of these hearings is on the interface between the not-for-profit and for-profit sectors. We believe that there may be some uncertainty as to the similarities and differences between the two sectors in the health care area. Health care services are provided by both sectors with many surface similarities. To understand the not-for-profit health care sector and how it differs from the for-profit sector, however, the Subcommittee cannot rely on a single, one dimensional "snapshot." Rather it must take an "x-ray" and look inside the institutions, and then evaluate this picture in light of the history of our nation's health care system.

The fundamental distinction between the not-for-profit and for-profit health care sectors is their essential purpose, their mission. The names of the two sectors provide apt descriptions of their essential purposes. The essence of the not-for-profit health care sector is that it is *not*-*for*-profit. The essense of the for-profit sector is that it is *for* profit.

The purpose of the not-for-profit sector is *for* healing, *for* community service, and *for* medical education and research, as described above. The governance of our institutions by trustees, who are members of the community, and the use of community volunteers are powerful evidence of community control of and support for our institutions.

Our institutions are *not for* profit in the sense that surpluses of income over expenses may not inure to the benefit of any individual. Rather, the not-for-profit health care provider uses such surpluses to expand health care services, meet future capital needs, and cover future deficits. Not-for-profit institutions must earn a surplus when circumstances permit because the failure to do so would result in at least a gradual degradation in the quality of service, and perhaps even in the failure and closing of the institution.

Indeed, the Internal Revenue Service, ruling on the characteristics necessary for a hospital to be eligible for tax-exemption, stated that a hospital with an "annual surplus of receipts over disbursements" was eligible for tax-exemption because "[b]y using its surplus funds to improve the quality of patient care, expand its facilities, and advance its medical training, education, and research programs, the hospital is operating in furtherance of its exempt purpose." _5/

Not-for-profit institutions are judged by their communities by different standards than for-profit hospitals are judged by their shareholders. The communities that we serve judge us not on the basis of our rate-of-return on invested capital, but on our "rate-of-return" of essential health care services to them.

The not-for-profit health care sector does, however, share many important attributes with the for-profit sector. We too must respond to a changing market and the demand for reduced health care costs. We must prudently invest our surplus, when we can earn one, so that funds are available when needed. But we are only "commercial" in the sense that some of our activities are also conducted by for-profit businesses. We are only "entrepreneurial" in the sense that we must manage the risk of new enterprises because this is necessary to respond to changing community needs in times of revolutionary environmental change. Indeed, the not-for-profit sector has led the health care system in developing innovative solutions to health care problems, without the political and bureaucratic constraints of the governmental sector and the for-profit sector's reluctance to initiate even worthy projects that promise high risk but low return.

The segment of the not-for-profit health care system represented by the Catholic Health Association, about 20 percent of all non-governmental, not-for-profit hospitals, distinguishes itself even further from the purposes of the for-profit sector. Our history began almost 2000 years ago with the healing ministry of Jesus Christ and continued with his disciples who dedicated themselves to easing human suffering: physical, emotional, and spiritual. The Christian nursing ministry developed further in response to plagues, epidemics, war, and the increasing health care needs of the general public. In 1542, a Catholic order established the earliest North American hospital still in existence. The first religious hospital in the United States was a Catholic institution established in 1727.

The order to which I belong, the Daughters of Charity, has been practicing its Christian nursing ministry for 354 years. Our first U.S. hospital was established in 1828. In 1861, at President Lincoln's request, we established Providence Hospital here in Washington, D.C., to care for the wounded from both sides of the Civil War.

Compared to the average community hospital, Catholic hospitals are larger, have higher occupancy rates, and provide a greater number of services to their communities, especially services that, while needed by the community, do not provide adequate reimbursement, such as burn centers and neonatal units. In addition, Catholic hospitals are often the lowest cost hospitals in the community and are committed to caring for all regardless of their ability to pay.

But the fundamental difference between the not-for-profit and for-profit sectors is their purpose. The purpose of not-for-profit health care institutions is healing, teaching, research, and community service. The

Daughters of Charity have stated their mission as "healing and service to the sick and poor." Our activities are directed toward the preservation of our "concern for the poor, the maintenance of quality standards of performance, the development of leadership for Christian service, and the responsible use of human and financial resources."

Investor-owned, for-profit institutions must have as their purpose earning a profit to provide an acceptable rate-of-return on invested capital for their shareholders. It is this difference in essential purposes that dictates the different behaviors of the two sectors, the different services they provide, and the different locations where they provide these services. And it is these fundamental differences that justify the different tax treatment of the two sectors.

C. The Continuing Revolution in Health Care

Much has changed in the health care delivery system, and particularly in the not-for-profit sector, since the UBIT law was enacted in 1950. Indeed, it sometimes seems that the only thing that has remained the same is our purpose of promoting health. I have been with the Daughters of Charity since the early 1950's. Since that time, there have been enormous changes in the needs of communities and in the governmental and operating environment in which we function, and therefore in the nature and location of our activities and the specific methods and structures with which we perform these activities.

In the 1950's, there was little health insurance; patients generally paid for their own care as they needed it. I recall payment at our mid-west hospitals was sometimes made with dairy and agricultural products. Charitable contributions were a significant source of support for our operating and capital needs. Our capital needs were much smaller then because the technology was less expensive, but it also was less effective and, therefore, the medical results often were much inferior. There was little federal government involvement, other than the Hill-Burton construction grant and loan program.

1. Change in Community Needs

Since that time, the needs of communities have increased tremendously:

- Communities have asked their hospitals to provide new services such as drug and alcohol treatment and rehabilitation, neonatal centers, burn centers, the newest diagnostic methods such as CAT scanners and MRIs, the newest procedures such as cardiac bypass and transplant, and most recently AIDS treatment. The not-for-profit sector has lead the way in providing these services.

- Communities with growing populations have asked that we come to them and open new facilities, or expand existing facilities. The not-for-profit sector has responded in areas where the slight prospect for "profit" would not attract for-profit institutions.

- Governments have asked us to help relieve their burdens by continuing to operate in areas where many persons have no way of paying for needed medical services. We have responded, in some cases by merging failing inner-city institutions with financially stronger suburban institutions.

2. Change in The Environment

Of greater importance, however, are the revolutionary changes that have occurred in the health care environment since the 1950's, and which continue to occur today. A significant number of these changes have been caused directly or indirectly by the Federal Government:

- The Medicare program, enacted in 1965, created access to and guaranteed payments for medical care for the elderly and the disabled. This became the most reliable and therefore significant funding source for hospitals, which formerly depended on the few individuals with insurance, charitable contributions, volunteers, and government grants to break even. Medicare now accounts for over 40 percent of hospital revenues.

Medicare provided access for large numbers of persons to needed medical care and resulted in a tremendous increase in our ability to provide health care services. But over time it also created behavioral incentives that worked against the health care system. For example, by paying on a cost basis, Medicare encouraged longer lengths of stay. By requiring reduction in reimbursement in the amount of endowment earnings, Medicare discouraged charitable giving.

- The Hill-Burton program, which provided grants and loans for hospital facilities construction, was phased-out. In its place, state and municipal authorities were empowered to issue tax-exempt bonds and loan the proceeds to not-for-profit health care providers in order to finance their growing capital needs. Tax-exempt bond financing is now the predominant method of financing replacement, renovation, and expansion projects for not-for-profit health care facilities.

- Several factors fueled an enormous expansion in the for-profit sector of the health care system: Medicare's promise of guaranteed revenues; the recognition of fair market resale value for rebasing depreciation when facilities are purchased (just recently repealed); the investment incentives of the Economic Recovery Tax Act of 1981 (which provided fast depreciation of real property and equipment and additional tax credits for equipment for taxpaying entities); and the guaranteed Medicare return-on-equity payment. The number of for-profit hospital beds increased 18 percent from 1981 to 1985, while the total number of hospital beds declined slightly. During the same time, the number of not-for-profit beds stayed the same, and the number of public hospital beds declined 10 percent.

- In 1983, Congress radically changed the Medicare reimbursement method from payment of costs to the Prospective Payment System (PPS), which pays a fixed amount to the hospital for each patient based on the diagnosis of his ailment. At the same time, private health insurers and large employers, concerned about their costs, decided to apply free market disciplines to the health care delivery system. Alternative health care delivery and financing mechanisms such as HMOs and PPOs were established. In addition, commercially insured patients were required to pay directly at least part of their health care costs through the imposition of deductibles and co-payments. These factors placed tremendous additional pressures on hospitals to cut costs and to find new revenue sources. The response of physicians and hospitals has been to reduce the length of stay, to shift patient care to less expensive delivery methods and facilities, and to be more cautious in the use of expensive diagnostic tests.

- The Federal Government has proceeded to force further major economies in the health care sector by reducing annual Medicare payment increases below the increase in the prices of hospital inputs. Last year this Committee and then Congress also reduced payments for hospital capital expenditures below actual costs.

- Charitable contributions have been declining for many years, placing greater emphasis on the ability to support the exempt purpose of the institution with income-producing activities. Last year Congress terminated the charitable deduction for persons who do not itemize their taxes. This will further discourage charitable contributions to not-for-profit health care organizations.

- During all this time, the medical state of the art has been advancing rapidly. More powerful and more expensive technology has been deployed in our war against disease. As a result, we are able to heal those whom we previously could only comfort. Another result is that since all Americans believe they have a right to the best health care available, this technology, often expensive, is widely demanded. Financing for equipment is an ever increasing part of our capital needs.

- Congress last year imposed several new limitations on our ability to finance needed capital projects. Since we cannot issue equities (as for-profit health care institutions may) and, as described above, charitable contributions have been reduced, most of our capital needs are met through tax-exempt bond financing. One of the changes in the tax law last year was the imposition of a $150 million limit on the amount of outstanding tax-exempt bonds other than for "hospitals," which were narrowly defined to exclude precisely the types of low cost, innovative health care facilities we are moving toward. This will undoubtably complicate our ability to continue to respond to changing community needs and medical technologies and will inevitably result in distortions in the health care delivery system.

In sum, the story of the health care environment in the last two decades is one where both the Federal Government and health care providers have sought to improve the health care system, and with considerable success. But the environment has changed so much and so fast in the past several years, and often so unpredictably and inconsistently, that we have often had difficulty understanding and adapting to it. We are adapting, however, and what you see in a "snapshot" of us today is a system in transition.

3. Future Trends In Health Care

As to future trends, we see the combined effects of decreasing federal operating and capital reimbursement, sharply reduced tax incentives to invest in structures and some equipment, and further reductions in private reimbursement payments making the overall health care system much less "profitable." We are already seeing some large for-profit systems selling their least profitable hospitals. This again is an appropriate response in light of their purpose; it is how the free market system is supposed to work. The free market is now reallocating capital away from health care to investments of equal risk with higher rates-of-return on invested capital. This will in time have the effect of reducing excess capacity, that to some extent was caused by the increased "profitability" of health care, or at least some parts of it, with the advent of cost-based reimbursement.

In the long-term, we believe that not-for-profit health care providers will remain the predominant form of health care delivery in the U.S., providing the vast majority of the nation's hospitals and hospital beds, and more importantly providing the bulk of community health services, medical education and research. Our long-term dedication to health care, not only when it is profitable, will insure that we retain our preeminent position in our nation's health care system. Our ability to adapt to change and to pay our way over the long-term will serve us, and the American people, as well in the future as it has in the past.

We think it is particularly important that the Subcommittee be mindful of the future when evaluating the not-for-profit health care system today. The "snapshot" that one may take today of a health care system in transition is not representative of either the long tradition of not-for-profit health care providers or the likely future of such institutions in many respects. To the extent that there are surface similarities with for-profit health care providers today, these result primarily from the enormous pressures from the Federal Government and private sector payors to become more "competitive."

It would be ironic indeed if the Congress were to alter the tax treatment of our institutions because of perceived similarities with the for-profit sector, when the Federal Government has created or encouraged the principle environmental changes which have led to this change in the surface appearance of our institutions.

The principle that has now been thoroughly adopted by the Federal Government and private payors -- that they will pay strictly for the services provided the patient for whom they are responsible -- is, under the current system, in direct conflict with the principle that all Americans have a right to adequate health care. Not-for-profit hospitals can provide services for those unable to pay only through government grants, charitable contributions, volunteerism, or cross-subsidization. Cross-subsidization, formerly the most significant method of providing funds for the persons unable to pay for their own medical care, is becoming increasingly difficult if not impossible, and no replacement has been put in place by the government or the free market.

Let me stress, however, that despite these enormous changes in the environment, our core commitment to our communities remains unaffected. For example, the Daughters of Charity has an explicit mission statement, and even explicit indigent care requirements, to insure that we do not lose sight of our mission despite the continued pressures to act in a commercial manner. Congress must look to the future of our health care system, where it is going and where we want it to go, in making any decisions to change the tax treatment of the activities of not-for-profit health care institutions.

D. The Activities of Not-For-Profit Health Care Providers

The stated focus of these hearings is to examine the "income-producing" activities of tax-exempt organizations. We will now describe our activities in order to provide the Subcommittee with the comprehensive profile of our institutions that is necessary for a reasoned consideration of any changes in the UBIT law. It is important to understand, however, that not all of our activities produce income. Last year, not-for-profit hospitals provided an estimated $4 billion plus in free care. We believe that even this figure substantially understates the true contribution of our institutions to the needy because until recently, there was no reason to expend the resources necessary to completely document this statistic.

However, we are, and must be, engaged in "income-producing" activities. Virtually any tax-exempt organization which is not engaged in such activities in today's environment of shrinking charitable giving and government reimbursement may not be able to continue to perform its exempt activity for long.

It is also important to understand that most of our activities that produce income are the provision of acute care services, the central function of our hospital system. It does not appear that there are any allegations that our provision of acute care hospital services is not an exempt purpose, is "unfair competition" with for-profit hospitals, or should be subject to tax. The fact is that much of our activities involve the provision of "unprofitable" services and the operation of facilities in "unprofitable" locations. This is a commitment that for-profit health care providers would not or could not choose to duplicate.

Rather, the focus appears to be on the non-acute care activities that we perform. I believe that a description of the non-acute care activities of the Daughters of Charity National Health System will provide the Subcommittee with the explanation it has requested of the type, nature, and extent of "income-producing" activities of not-for-profit hospitals.

1. The Daughters of Charity National Health System

The Daughters of Charity National Health System is our nation's largest not-for-profit health care provider in terms of beds and revenues, although we are smaller than the four largest for-profit health care providers. We have recently converted from a regional to a national health care system of 38 hospitals and 5 other facilities (mainly nursing homes) and now comprise more than 13,000 acute care beds in 17 states and the District of Columbia.

Our hospitals are generally large, urban, tertiary care facilities that average 350 beds. They are among the oldest health care institutions in their communities, although most of the original facilities have been replaced or renovated through the use of tax-exempt financing.

Service to the poor has been an essential part of the mission of our order for the last 354 years. We provide about $50 million annually in free care to the medically indigent, not including bad debts or shortfalls in government reimbursement. In addition to charity care provided in the hospital setting, we fulfill our mission by developing a variety of outreach programs which directly benefit the poor.

To support our mission today, and to maintain our ability to perform our mission in the future, we are presently engaged in or are considering a number of non-acute care, "income-producing" activities that may be of interest to the Subcommittee. There are three reasons why we are involved in health care services other than acute hospital care: a) to respond to changing community health needs in a changing environment; b) to reduce our costs; and c) to increase revenues to pay for other needed health care services.

2. Responding To Changing Health Care Needs

Most of our activities can be understood in the context of our efforts to preserve our mission in a time of changing community health care needs and in a time of even more revolutionary change in the delivery and financing of health care. This imperative explains most of the services we provide and the locations in which we provide them. Many non-acute care services are provided to maintain the continuum of care that we believe is the most effective and the most efficient way to deliver health care services. In many cases, providing a linkage between the acute care provider which treated the original problem and the provider of subsequent lower levels of care is a significant benefit to the patient. For example:

a. We are now selecting a joint venture partner to provide new prepaid care insurance products, a triple option of health maintenance organization, preferred provider organization, and indemnity insurance plan. Although prepaid health care is not new to us (in 1874, we established the first prepaid preferred provider system in Michigan by selling $5 tickets to loggers for unlimited care at St. Mary's Hospital), the precise nature of the plan is an innovative response to today's needs and environment.

b. In response to the growth in the elderly population and their medical needs, we expect to add more long-term care facilities and additional "elder care" services. We will accomplish this task with more difficulty than if this Committee and then the Congress had not decided last year to limit the amount of tax-exempt financing for these types of facilities.

c. We are now engaged in or are considering lower levels of patient care services such as intermediate care and home health care, including the provision of related durable medical equipment.

We believe that these responses to the increasing health care needs of the communities we serve, and to the governmental and operating environment in which we operate, are fully consistent with our charitable purposes. Indeed, they are in some cases essential to continue our mission.

3. Cost Reduction

The second reason why we engage in non-acute care activities is to reduce our costs. For example:

a. We have reduced costs through the economies of scale resulting from combining our regional systems into one national system. These economies include our joint purchasing program and a more efficient use of management resources.

b. We plan to bring "in house" the functions of executive search and travel plan arrangements. These services will be provided solely to our personnel. We believe that we are large enough to more economically perform these activities internally than to continue to purchase them from outside businesses. These activities will not be "income-producing" because they will be performed solely for our personnel.

4. Revenue Enhancement

When we need revenues to avoid or reduce a deficit from the operation of acute care hospitals, we cannot raise taxes, but we can find other sources of funds.

Over the years, the way we finance our mission has changed many times. In the early years of the Church, the money came primarily from donations. In many cases charitable giving is still very important because, although it is insufficient to provide all the capital necessary for a major replacement or renovation project, it is needed to provide equity to support the issuance of tax-exempt bonds. This is used to increase the quality of a bond offering, and thus lower the interest rate, by requiring less borrowing. It is even more important now because Congress last year placed a limit on the amount of issuance costs that could be financed through tax-exempt bonds, which means we must now fund any excess with our equity.

Federal assistance under the Hill-Burton program of construction grants and loans was another important source of funds that has been terminated. Today the Medicare and Medicaid programs are the most significant federal assistance programs. The bulk of our funds are from those programs and other third party reimbursement. All of these revenue sources, however, are contracting.

For various reasons, many of the non-acute care services that we provide can be provided with a surplus of receipts over expenditures. This is one reason we are expanding these activities.

In addition, when we earn a surplus, we must invest it prudently. We have found that joint ventures are good ways to invest our surplus for the reasons explained below. We generally operate these joint ventures in health-related areas because, in addition to being an investment for our future, these entities assist us in performing our health care mission today.

E. The Structure of Not-For-Profit Health Care Providers

The structure and business relationships of not-for-profit health care providers are other areas of change since 1950. These changes have occurred at the individual hospital level and at the system level, and they have included joint ventures with other entities.

1. Hospital Corporate Structure

Several years ago, many hospitals restructured to create a structure which typically includes a not-for-profit parent, a not-for-profit hospital, a not-for-profit foundation, and perhaps one or more affiliates, either not-for-profit or for-profit.

There were several reasons for these restructurings, for example:

- Where the new activities are subject to rules and regulations different from those applicable to acute care hospitals, the separation of these activities into discrete entities facilitates management and compliance with different regulatory environments.

- Through the creation of for-profit subsidiaries, which pay taxes on their net income before the after-tax income goes to the not-for-profit hospital, we have been able to integrate into our total health care system certain services in which we otherwise would be unable to participate. This is because the amount of unrelated income from these services within the tax-exempt hospital could have jeopardized our tax exemption by possibly exceeding an "insubstantial" amount of our total income.

2. System Formation

Another change since 1950 is the recent growth in the number and size of multi-hospital systems, both not-for-profit and for-profit. There were several reasons for this development:

- Financially weaker hospitals needed the support of financially stronger hospitals to keep their doors open and to continue to serve their communities. This is a form of cross-subsidization between hospitals and a form of insurance over time, as well.

- As discussed above, there are substantial economies of scale in larger organizations.

- In the case of religious institutions, a related reason is the declining number of sisters and the consequent need to retain control over our religious hospitals with more efficient senior management structures.

It is important to understand, however, that by preserving a very decentralized management structure within our system, we have retained the ability to respond to the unique mix of health care needs of each community that we serve as we have consolidated our system.

3. Joint Ventures

Joint ventures have assisted us in performing our exempt purpose in several ways:

- They have provided the ability to tap into the expertise of other organizations in forming new types of health care services.

- They have allowed us to access new sources of capital needed to further our mission in the face of federal efforts to restrict our access to tax-exempt bond financing.

- They have allowed us to be directly involved in the security and performance of the investment of our surplus until it is needed for other health care operations.

For example, the joint venture structure will be employed in our planned prepaid insurance program because it is the best way to benefit from the experience of an insurance company and the commitment of local physicians, while controlling the destiny of this important effort.

F. Competition With For-Profit Non-Acute Care Businesses

There are several reasons why a not-for-profit health care provider would engage in a non-acute care activity that may also be provided by a for-profit business:

1. As a general matter, there is a tremendous overlap in many parts of our dynamic economy between the activities performed by the public, for-profit, and not-for-profit sectors. It should come as no surprise that this overlap exists in many health care areas.

2. To accomplish our exempt purposes, not-for-profit health care institutions require that certain non-medical services be provided on a permanent basis at consistently high levels of quality and reliability. These services must be provided according to health care needs rather than commercial concerns, regardless of whether the forces of supply and demand make their provision profitable or unprofitable at any point in time. The free market cannot do this. These services include:

- food, laundry, laboratory, and pharmacy services;

- health care services that can be provided with better theraputic results in the hospital setting or otherwise in close connection with hospital personnel;

- services that must be provided by the not-for-profit hospital for necessary safety and convenience, such as parking lots, which increase access to the hospital by providing safety and convenience for staff, patients and visitors, and cafeterias, which keep our medical staff employees on call even when they are eating.

- gift shops for the use of patients and their families, which have an indirect, but worthwhile, impact on patient care.

3. Because our mission is to take care of the sick regardless of ability to pay and to provide necessary services even if they are inadequately reimbursed, we sometimes engage in services that are provided by for-profit businesses only to those who can afford to pay.

We recognize and appreciate that our not-for-profit institutions enjoy certain advantages over for-profit businesses in providing goods or services. It is also important to recognize that for-profit small businesses enjoy important advantages over not-for-profit institutions, including small business assistance programs that provide grants, loans, government purchasing set-asides, and research grant allocations, and the ability to raise equity capital.

In addition, the not-for-profit health care sector provides a hidden subsidy to small businesses through our provision of free care to uninsured persons, many of whom are employees of small businesses that do not provide adequate, or any, health insurance. It is our belief that, on balance, the factors favoring not-for-profit institutions do not amount to "unfair competition" with for-profit businesses.

Moreover, it is clear that in virtually all cases competition between entities supplying a good or service is sought by consumers and opposed by suppliers. It should come as no surprise that some businesses do not like to compete with not-for-profit organizations, or with other for-profit businesses. The two questions that the Subcommittee should focus on are: 1) who benefits from competition; and 2) who would be harmed by higher prices, by reduced access, or by reduced quality, reliability or permanence of the provision of the services that are the subject of allegations of "unfair competition"?

III. The Unrelated Business Income Tax

A. The Purpose of UBIT

The purpose of enacting the UBIT law was to counteract perceived unfair competition with for-profit businesses. 6/ It was the Congressional response to the increasing involvement of tax-exempt organizations in "income-producing" activities.

Under prior law, the destination rather than the source of income was the controlling test in determining whether the tax-exemption should be denied to organizations with "income-producing" activities on the grounds that they were not organized and operated exclusively to further their exempt purposes. Most organizations passed this test, including the notorious Mueller Macaroni case where the company was found to be tax-exempt because it paid all of its profits to an exempt organization, New York University.

However, in enacting the UBIT law, Congress did not intend to eliminate all competition between tax-exempt and tax paying entities. Rather, it recognized that tax-exempt organizations may engage in income-producing activities in furtherance of their exempt purposes, and that this should be allowed without taxing the income from these activities if they meet the test of relatedness to the organization's exempt purpose. Indeed, Congress permitted tax-exempt entities to engage even in activites unrelated to their exempt purpose as long as tax is paid on the income from such activities and the activities do not constitute a substantial part of the activities of the exempt organization.

We support this approach. We believe that the concept of relatedness is sound and meets the objectives of Congress in enacting the UBIT law.

B. The Implementation of the UBIT Law

We believe that the three-part, facts and circumstances test, requiring a finding of a "trade or business", "regularly carried on", and "not substantially related to the organization's exempt purpose," properly implements the concept of relatedness. This flexible test is a reflection of the reality that there are a wide variety of exempt activities being conducted by tax-exempt organizations today, and that these activities and their implications change over time. The fact that this test has enabled the UBIT law to function well, despite the great changes in health care needs and the revolution in the health care environment, is strong evidence of the vitality of the test and the way it has been implemented and applied.

The task of defining in advance what activities should be considered "related" to each exempt purpose recognized in the Code would be impossible. Rules of law or presumptions providing that specified types of activities are related to specified exempt purposes would often mis-characterize the true nature of the relationships and create inequities that do not exist under the present law and regulations. Even if all of these relationships could be assessed today, there would be no way to take into account future changes in health care needs or the environment without amending the law. While we do not think that all of interpretations of the UBIT law have been correct, we think the law works as well as most parts of the Code.

We see no evidence of abuse that would justify changing the language of the test in an attempt to circumscribe further the universe of permissible activities. Any such change in the language of the test would result in years of uncertainty as new interpretations defined the contours of the new standard. It is extremely unlikely that any reduction in competition with for-profit businesses or increased UBIT tax revenues would justify the costs to both tax-exempt and taxable businesses of changing the test.

C. Application and Compliance

The body of law that has interpreted and applied the substantially related test to not-for-profit health care institutions is well developed and generally reflects well-reasoned tax policy and even-handed enforcement. These decisions generally strike an appropriate balance between fostering socially desirable exempt purposes and avoiding unfair competition with for-profit businesses.

It generally appears to be administered as well as could be expected in light of the fact that it is a facts and circumstances test which leaves much discretion to the individual revenue agent. The one significant problem with its administration is the long delay in getting advance rulings, which appears to result from inadequate allocations of personnel by the IRS to review requests for such rulings.

We believe that not-for-profit health care providers and their accountants, auditors, tax advisors, and legal counsel are well aware of the UBIT law, its interpretation and application to their institutions, and their responsibility to comply with the law. We believe that compliance with the law by our institutions is high.

IV. Conclusion

We hope that our description of the nature and extent of our "income-producing" activities and the application of the UBIT law to them will provide the Subcommittee with sufficient information to consider any changes in the tax laws affecting not-for-profit health care providers with the proper perspective.

We believe that the current legislative, regulatory, and judicial treatment of UBIT as applied to not-for-profit health care facilities is appropriate. We do not believe that enough is known about the nature and extent of the allegations of unfair competition to make any change in the UBIT law.

We would be pleased to assist the Subcommittee in evaluating any alleged abuses of the law.

FOOTNOTES

1/ *See* House Ways and Means Committee Report, Revenue Act of 1938, H. Rep. No. 1860, 75th Cong. 3d Sess. (1939), at 19. *See McGlotten v. Connally*, 338 F. Supp. 448, 456 (D.D.C. 1971), aff'd sub nom. *Coit v. Green*, 404 U.S. 997 (1971).

2/ *See* J.S. Mill, *On Liberty* (1859); testimony of Treasury Secretary George Shultz before the Ways and Means Committee, "Proposals for Tax Change," Department of the Treasury, April 30, 1973, at 72.

3/ *See* Commission on Private Philanthropy and Public Needs, *Giving in America--Toward A Stronger Voluntary Sector* (1975).

4/ Rev. Rul. 69-545, 1969-2 CB 117.

5/ *Id*.

6/ *See* Treas. Reg. sec. 1.513-1(b).

Mr. Flippo. Mr. Owen.

STATEMENT OF JACK W. OWEN, EXECUTIVE VICE PRESIDENT, AMERICAN HOSPITAL ASSOCIATION, ACCOMPANIED BY JOHN D. LEECH, CHAIRMAN OF THE BOARD, HILLCREST HOSPITAL

Mr. Owen. Thank you, Mr. Chairman. You have the AHA's formal testimony, and I would like to give my minutes to John Leech, chairman of the board of Hillcrest Hospital in Cleveland, Ohio, who can give you information directly from an institution, and I will be happy to answer questions of a general nature following the panel presentation.

Mr. Leech. Mr. Chairman and members of the subcommittee, my name is John Leech, and I am chairman, not of the American Hospital Association, but of Hillcrest Hospital, a 325-bed community hospital located in Mayfield Heights, Ohio, a suburb of Cleveland.

I am also chairman of the Health Trustee Institute, a non-profit organization involving 1,800 individual trustees of nearly 45 nonprofit hospitals in the northern Ohio area.

I am also an attorney with the firm of Calfee, Halter and Griswold, and I have 22 years experience in both health care as well antitrust law. My clients now include numerous nonprofit hospitals, a single for-profit hospital, nonprofit and for-profit alternative delivery systems, and joint venture arrangements between physicians and hospital entities.

The reason I mention this background is that I am familiar with both the operations as well as the legal structure of hospitals, and especially profit and nonprofit interests engaged in the health care delivery industry.

I appreciate the opportunity as a private uncompensated trustee of a nonprofit hospital to present the position of the American Hospital Association, which has been set forth in their written statement, which was previously submitted to the subcommittee. I would like to put into perspective the types of new and innovative activities which have been entered into by either my hospital system or by other tax exempt health care clients of our firm.

Each of the following activities was placed in a for-profit corporation and to the extent that revenues exceeded expenses, taxes were paid on those activities. These activities include the sale of dialysis supplies to non-hospital patients, clinical lab services for sales in physician offices, sales of durable medical equipment, management corporations for the management of nursing homes and physician offices, billing services and physician answering services.

Because these activities focus on the sale of goods or services to the public at large, however, I believe it would be very difficult from a legal standpoint to clearly state that they are substantially related to exempt purposes of tax-exempt entities which partially own them. Hence, if they were conducted directly by these tax-exempt entities, the revenues would be unrelated business income and if it was substantial that income could jeopardize the very tax-exempt status of the owners and operators.

It should be recognized though that where a tax-exempt entity has entered into an activity itself or through an affiliated corporation which is not clearly in furtherance of its tax-exempt purposes, certain economic principles can't be ignored. These will occur.

The only reason that a tax-exempt entity enters into an unrelated business such as a bowling alley or catering service is to generate income. Therefore, the very business principles dictate that such a corporation will charge as much as it can in the marketplace for its services or products and act as any typical for-profit competitor.

The decisions made as to pricing levels or market penetration will be dictated by a profit motive rather than how those activities relate to the other tax-exempt entities or purposes.

Such organizations will not behave in a destructively competitive manner or cause economic harm to competitors merely because they are affiliated in some fashion with a tax-exempt organization. On the other hand, my hospital system and many of our tax-exempt health care clients have also entered into other activities which are also placed in separate for-profit corporations.

The difference in these activities, however, is that they are clearly substantially related to the tax-exempt purposes of their owners and operators and among the types of activities that were included were, off campus emergency centers, radiation therapy and diagnostic services for both in-patients, out-patients and patients unrelated to the owners, diagnostic ultrasound centers and others.

These activities conducted by the for-profit organizations are not designed to create profits. Rather they are designed to provide additional health care services or better permit access by patients to needed supplies or services. You may ask why were these activities not conducted within the corporate organization of the tax-exempt entities themselves.

The reason for creating separate for-profit corporation structures is not dictated by tax-exempt considerations, and it shouldn't be. It is by other basic business reasons, including the desire to narrow the risk of liability solely to the corporation performing the services, not jeopardizing the other corporations involved in the operations.

Two, to create an accountability by creating specific corporations with their own employees who are responsible for both those activities and expenses as well as any profits that are generated.

Three, to apply the actual overhead required for those services to the revenues generated so that these services can be more cheaply provided than if they were saddled with the overhead that would be associated with the large acute care institution.

We have advised our nonprofit tax-exempt clients, therefore, that even if it can be easily determined that the proposed activities are clearly in furtherance of their tax-exempt purpose, for other business reasons it makes sense to create a separate for-profit corporation for such activities.

I am pleased to report that our advice has generally been accepted, and there are business reasons, and not alleged tax-exempt loopholes, that have really dictated the structure for those corporate activities.

Another question has been raised as to the amount of taxes paid on UBI. As far as my experience is concerned, I am aware of little, if any, tax which has actually been paid on activities generated by unrelated business income in the health care industry.

The reason for this is that these activities have been started fairly recently, within the last two or three years. Therefore, the organizations have incurred significant startup costs, and their sales really haven't generated enough income to become taxable, which is not atypical of a for-profit organization.

Many, if not most, of these entities have tax loss carry-forwards, so that the taxes will be delayed for some years. Even though these entities are associated with nonprofit corporations, and are entering into markets previously dominated by smaller for-profit corporations, it is not a sufficient reason alone to make any massive changes in the provisions of the Internal Revenue Code.

We feel that enforcement of the existing provisions for taxation of UBI of tax-exempt health care delivery organizations, and not changes in the law, is appropriate. These experiments by tax-exempt hospitals in providing needed health care services, and new less costly methods, must be permitted to run their course.

The nonprofit health care sector must remain economically viable. It must survive and be healthy, since in the long run I am absolutely convinced that those tax-exempt corporations will still be responsible for providing the major portion of indigent care, medical research and educational and wide spread community access to hospital facilities.

Therefore, the American Hospital Association supports your review of this area, and we would be very pleased to cooperate further in supplying you further information.

Thank you very much.

[The prepared statement of Mr. Owen follows:]

American Hospital Association

AHA

Capitol Place, Building #3
50 F Street, N.W.
Suite 1100
Washington, D.C. 20001
Telephone 202.638-1100
Cable Address: Amerhosp

STATEMENT
OF THE
AMERICAN HOSPITAL ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
OF THE
U.S. HOUSE OF REPRESENTATIVES
ON
UNRELATED BUSINESS INCOME TAXATION

June 26, 1987

SUMMARY

The American Hospital Association (AHA), which represents over 5,600 member hospitals and health care institutions, as well as more than 40,000 personal members, welcomes this opportunity to present its views concerning review of the unrelated business income tax (UBIT). The complex health care industry continues to go through major adjustments following change in Medicare payment philosophy and methodology, increase in popularity of services provided through managed care programs such as HMOs and PPOs, and pressure for cost-saving and specially tailored programs by employers. Our statement will place the definition and interpretations of related income in the context of the health care field, and will discuss both why current unrelated business income provisions are workable, and what the consequences of significant change in them would be to the hospital industry. It is our intention not to rebut anecdotal reports of unfair activities, but to highlight the unique nature of the hospital industry with respect to these tax provisions. In addition, we will stress the importance of waiting for the results of the current, comprehensive IRS audit before changes are considered.

INTRODUCTION

The complex health care industry continues to go through major adjustments following the change in Medicare payment philosophy and methodology, increase in popularity of services provided through managed care programs such as HMOs and PPOs, and pressure for cost-saving and specially tailored programs by employers. The emphasis on cost containment and competition in health care delivery has increased the importance of efficient management, competitive business ideas, and adequate capital funding. Tax-exempt hospitals must come to grips with these forces in the context of their historical missions to provide services for the benefit of their communities. These missions include, among others, provision of charity services; commitment to medical education and research; availability of specialized treatment services, which may or may not be self-supporting; and provision of community education programs and screening services. The hospital industry currently provides needed health care to the American public through a balanced system of diversified sponsorship: not-for-profit, government, and for-profit hospitals. This pluralistic system, and the freedom to continue to choose responsible and appropriate forms in which health care services are delivered, are important to the continued vitality and quality of health care in this country.

It would be detrimental to the delivery of high-quality health care services to drastically change the rules governing the operations of tax-exempt enterprises, on which 85 percent of the nation's hospitals rely. Any change in tax policy that would decrease the ability of these hospitals to engage in appropriate revenue-raising activities would undermine the competitive model of health care and the promise of continued high quality services.

Our statement will examine the definition and interpretations of related income in the context of the health care field, and will discuss both why the unrelated business income provisions are workable, and what the consequences of significant change thereto would be to the hospital industry. It is not our intention to rebut anecdotal reports of unfair activities, but to highlight the unique nature of the hospital industry with respect to these tax provisions. In addition, we will stress the importance of waiting for the results of the current, comprehensive IRS audit before changes are considered.

I. Existing UBIT Concepts and Why They Work

The concept of identifying certain activities as generating unrelated business income stems from a public policy belief that tax-exempt entities should pay tax on the income from activities unrelated to the primary purpose of the tax-exempt institution. In the case of hospitals, any income-producing activity not carried on for the benefit and convenience of the patients is taxed at regular corporate rates. In addition, such activities must be limited if the institution is to retain exempt status. Depending on the facts of a particular case, this limit must be between 15 percent and 50 percent of total activities, receipts, and expenses in order not to jeopardize exempt status.

The AHA believes that the current "relatedness" test is workable and appropriate. The test focuses first on the purpose of the tax-exempt institution, and then examines whether the particular activity furthers that purpose. Judicial and regulatory interpretations have appropriately focused on the nature of the activity, the beneficiaries of that activity, and any promotional efforts for it.

The concept of unrelated business income has been defined and refined so that it now provides an understandable, workable method of preserving the balance between public interest in the successful operation of tax-exempt institutions and recognition of the need for fairness in those operations in the public's interest.

To illustrate the appropriate nature of current parameters/to UBIT tests with respect to the health care industry, it is necessary to reexamine the elements of the tests with illustrative examples from the health care industry. Under current law, unrelated business income tax is imposed when the following three facts all are present: 1) the exempt institution is engaging in a "trade or business"; 2) such trade or business is being regularly carried on; and 3) the trade or business is not substantially related to the tax-exempt purpose of the exempt organization.

"Trade or business" has been defined as including any activity that is carried on for the production of income, including sale of goods or performance of services, and that, as a result, competes with a taxable business. A hospital-run pharmacy or clinical laboratory serving the public rather than patients, therefore competing with tax-paying businesses, is an example of such an activity. In addition, a "fragmentation" rule has been developed to deal with situations in which a part of a business' income may be considered "unrelated" and therefore taxable, again acknowledging the appropriate balance between operation of a business such as a laboratory and ensuring fair competition. Note that the existence or non-existence of an operating surplus is irrelevant to the issue of whether trade or business is "unrelated."

The frequency and continuity with which the activity is carried on can be determinative in interpreting the phrase "regularly carried on." However, if it is in the nature of the business to be sporadically or occassionally carried on, even by commercial enterprises, then the exempt entity that carries on the activity similarly will be deemed to be engaging in business on a regular basis. This test is rarely determinative for activities in the health care industry and has arisen infrequently. An example would be the operation of a concession at a local fair.

The phrase "not substantially related" requires that there be no substantial connection between achievement of the tax-exempt purpose and conduct of the trade or business. The nature of the trade or business must be examined in relation to the specific tax-exempt purposes of the organization. This is the test that has raised the most significant questions, both within the health care industry and in other contexts.

An activity that is performed primarily for the benefit and convenience of patients, medical staff, families of patients, employees, and officers will be considered to be "related" to the primary purpose of the hospital (i.e., the promotion of health) and income produced from such an activity will not be subject to income tax. In addition, there are statutory exceptions to the definition of unrelated business income tax if substantially all of the work in carrying on the business is done by volunteers, the business is the sale of merchandise, substantially all of which has been donated, or the business is the provision, at or below cost, of certain support services to less-than-100 bed hospitals.
A solid body of examples of hospital activities and IRS general findings as to existence of unrelated business income has grown over the past several years, appropriately focusing on activities that benefit patients and their families, medical staff, and employees. Following are examples of specific activities and their interpretation as "related" or "unrelated," which together paint a picture of sensible, controlled policy.

Laboratory services have been considered related when such services are provided to hospital patients, but unrelated when provided to non-hospital patients, for example, to private patients of staff physicians. Similarly, pharmacy sales generally will be considered unrelated when the pharmacy is open to the public. The exception may be in rural areas where items may not be available elsewhere in the community, and where sale to private patients may be considered related activity if considered an incentive to encourage doctors to practice in the community. It is considered related activity to lease space in adjacent buildings to physicians for offices. The rationale for allowing this is that such an arrangement may improve efficiency and quality in health care and is considered to be an arrangement for the benefit and convenience of patients. These examples illustrate an appropriate differentiation between activities provided for patients and those in the "public domain," which therefore are taxable. AHA believes that these tests ultimately result in the weeding out of inappro- priate activities from those that fulfill the public interests in the promotion of health.

Production of "passive income," e.g., investment income, does not come under the unrelated business income tax provision. The exceptions to this exemption are income from debt-financed property, interest, annuities, rents, royalties from a controlled corporation, or the organization's share of earnings from a partnership engaged in business. The intent in taxing the exceptions noted above is to remove the incentive for shifting of productive property unrelated to exempt purposes into the exempt sector in an attempt to shelter business income from taxation. AHA agrees that these exceptions trigger an appropriate level of scrutiny of "passive income" that can ensure fairness regarding the taxable nature of certain income.

In addition, the intricate rules regarding unrelated debt-financed income are important examples of legislative and regulatory action to correct a specific targeted abuse. Under these provisions, income from debt-financed real or personal property that is used for a reason unrelated to the institution's exempt purposes will be taxable. Again the relatedness must be substantial, as in the case of a hospital leasing debt-financed property to a group practice of its own faculty or medical staff. It is beyond the scope of our statement to delve deeply into the methods of application of this provision to the hospital industry. However, it is important to note that when, as in the case of this income, a particular abuse was targeted, rectification was accomplished without totally changing a workable system.

II. Consequences To The Hospital Industry If UBIT Law Is Changed

The issue here is how a hospital would be affected if tax provisions were changed to further restrict its ability to engage in activities now considered "related," and also the effect of classifying a greater number of activities as unrelated on the institution's tax-exempt status. From the point of view of knowledge regarding the extent and nature of financial consequences, precise data are lacking. When completed, the current IRS audit may yield the type of information required to make an informed assessment. At this time, however, it is clear that financial data and other information are simply not available to make responsible judgments.

The AHA believes that the public's interest is best served through an integrated system of providing health care services. Diversification with the goal of health promotion provides a coordinated approach to health care within a provider organization and among providers. AHA believes that such an approach benefits patients and the public in its potential for community access to high quality health care services.

Therefore, we must turn to an examination of the multiple reasons for which hospitals engage in activities outside their traditional role of providing inpatient care. These activities are, and must be, ultimately in furtherance of the tax-exempt purpose and goal of all hospitals--the promotion of health. The public's interests are served when hospitals go outside their role of acute-care providers to operate or cooperate in diversified activities within the health care arena. An integrated and coordinated approach to the delivery of all types of health care services benefits the communities served by tax-exempt hospitals.

As an example of a diversification method that has many goals, a hospital may choose to enter into a joint venture for the provision of services. Joint ventures are an important method of creating and maintaining critical ties with alternate delivery and financing entities such as HMOs, PPOs, ambulatory clinics, and home health programs, and ties with physicians or physician groups. Such ventures have important primary purposes other than revenue-raising, for example, to create or solidify relationships with physicians, who are "gatekeepers" to all levels of health care services. A partnership with a group of radiologists to purchase a CAT scanner that hospital patients will use is an example of such a venture. A motivation for other ventures, such as a drug rehabilitation clinic, may be to ensure continued access to post-acute care services. Not all joint ventures will involve the delivery of health care services, but a venture to purchase a medical office building near the hospital may have the multiple purposes of providing convenient access to physicians by patients, beneficial proximity of physicians to the hospital, as well as a source of revenue.

Joint ventures are subject to a test of relatedness to the hospital's exempt purposes, and, if unrelated, to tax on the income from the venture. AHA believes that, with the guidance of the IRS in the form of general counsel memoranda and Revenue Rulings, the hospital industry's structuring of activities as joint ventures is, and will continue to be, appropriately subject to the current workable unrelated business income provisions. It is important to the future of high quality health care at reasonable costs for hospitals to have the flexibility in structuring diverse activities to respond to community needs, to attract patients, and to use their facilities efficiently.

III. Other Protections Against Unfair Competition

The provision of health care services is highly regulated on both federal and state levels. These controls come in the form of protections offered by general business regulations, a variety of tax laws, and restraints particular to the health care industry such as licensing and accreditation provisions. In addition to the fact, discussed above, that the current legal framework for assessing unrelated income is workable and appropriate, a change in unrelated business income tax provisions is not necessary at this time as a check upon any alleged unfair competition in the hospital industry.

Hospitals are subject to many types of controls regarding tax payment. Even if a hospital has received federal tax-exempt status, it will be subject to tax on any unrelated activity, including income, and sales or property taxes on any revenue from for-profit subsidiary ventures. Also, prohibition against private inurement is an important control on a tax-exempt hospital's activities and a limitation in its ability to compete with tax-paying enterprises.

Many other regulations directly affect the maintenance of a fair competitive system. For example, the Medicare Anti-fraud and Abuse Law protects against illegal "kick-back" or incentive arrangements between providers, and hospital referral arrangements may be scrutinized for fairness in compliance with this law. An example of an arrangement that may be examined is an exempt hospital's partnership in a for-profit joint venture that operates a specialty clinic, and also either accepts referrals from the clinic, or refers to it. Traditional concepts regarding the avoidance of conflicts of interest are also at play in such a situation. In addition, the body of antitrust law applying to the health care industry has increased considerably in the past decade and illustrates the energetic restraint to unfair competition that antitrust protection provides.

CONCLUSION

The AHA supports the current IRS position that allows necessary flexibility in responding to the crisis of change in which hospitals find themselves. In order to remain fiscally sound and in a position to deliver services to the community and provide charity care, hospitals must be able to engage in revenue-producing activities that are competitive and within fair, defined limits. There will always be instances of inappropriate activities by tax-exempt entities and AHA in no way supports tax-exempt institutions that fail to comply with existing requirements. However, in light of the current lack of complete data and other necessary information on the methods and types of activities that relate to this issue, the AHA urges that any action regarding unrelated business income tax provisions await the completion of the IRS audit.

Mr. FLIPPO. Dr. DuVal.

STATEMENT OF MERLIN K. DuVAL, M.D., PRESIDENT AND CHIEF EXECUTIVE OFFICER, AMERICAN HEALTHCARE INSTITUTE

Dr. DUVAL. Mr. Chairman, my organization consists of 31 members. Each is a large not-for-profit hospital system and together they own, lease or manage approximately 490 tax-exempt hospitals.

They exist for the twin purpose of meeting the full spectrum of needs and expectations of an American public that believes that it has a right to health care, and to provide the settings for research and educational programs that make America's medicine the most advanced and admired in the world.

With help from the Federal Government in 1965, tax-exempt hospitals have come remarkably close to meeting the public's expectations by offering a full range of services irrespective of whether those services are economically viable, and whether or not the recipients of such services can afford to pay for them.

Beginning in the early 1980s, because of continuing cost escalation of medical care, American business, the largest single purchaser of health services, and the Federal Government through prospective pricing on behalf of Medicare beneficiaries, sought the deepest discounts they could get from America's hospitals.

This resulted in striking constraints on the revenue they had counted on to meet their twin objectives, their problem became how they could remain faithful to their public missions as their margins disappeared.

Our hospitals responded by arranging for treatment of patients at sites that were less expensive than in the hospital, by reducing admissions and length of stay, by closing approximately 80,000 hospital beds, and laying off approximately 170,000 employees.

They further reduced their costs by centralizing their management through corporate restructuring and by taking advantage of the economies of scale as for instance, through centralized purchasing.

Thus, while there has apparently been growth in the number of tax-exempt entities otherwise in the United States in recent years, the number of tax-exempt hospitals has been shrinking.

In pursuing their tax-exempt purpose some of our hospitals operate not-for-profit subsidiary corporations. Generally, these encompass activities such as educational and wellness, cooperative laundries, pharmacies, and durable medical equipment if they are also operating home care programs. I am told that gross unrelated business revenues for all of our hospitals totals approximately $25 million, that form 990–T's are filed, and that revenues from sources specifically excluded are, in the case of hospitals, very small.

Within our entire universe of hospitals we also operate approximately 160 for-profit subsidiaries that are, of course, subject to regular taxation. Their gross earnings constitute less than 0.5 percent of our total gross revenues and they are created principally to limit liability, to assure convenience, permanence, and quality control, as well as market share in those instances where vertical integration is essential.

Frankly, gentlemen, it is cleaner to set up a for-profit subsidiary than it is to run any risk with our tax-exempt status.

As for competition, for us the most intense competition is the investor-owned hospital chains. That they do well is evident. That they are not here complaining about competition is also evident.

American citizens feel they have a right to health care. Government alone has not delivered on that right. Instead, it has asked us to do so. We are trying and we think we do well. At the same time, we are criticized for the cost of sickness, and we are doing everything we can to get those costs down. This poses a dilemma, competition with small business. In this context, we totally support the rationale that underlies imposition of the unrelated business income tax. That tax is not intended to affect the tax-exempt status of qualified organizations. Neither does it preclude such entities from engaging in certain kinds of activities.

However, it is intended to impose taxes on unrelated commercial activities that are comparable to those imposed on taxable entities. In this context it is our judgment that the tax code continues to serve its purpose well.

If you decide otherwise, you can count on the fact that we will be prepared to help you refine, further clarify, and otherwise amend any points of contention that remains, and we will work with you and the members of your committee to that end.

Thank you.

[The statement of Dr. DuVal follows:]

Statement

# of the

American Healthcare Institute

Mr. Chairman, I am Merlin K. DuVal, President of the American Healthcare Institute. The American Healthcare Institute represents a national network of 31 voluntary not-for-profit health systems. These systems own, manage or lease almost 500 hospitals, and render direct services, by contract, to almost 900 others. It is the largest network of not-for-profit multi-hospital systems in the world, working to provide the American people with high quality health care at an affordable price.

We appreciate this opportunity to share our views about the unrelated business income tax features of the Internal Revenue Code and their meaning for our tax-exempt health care delivery organizations.

As you know, Mr. Chairman, the Code imposes the unrelated business income tax (UBIT) on any income that tax-exempt organizations derive from activities that are not substantially related to their exempt purposes. The purpose of the tax is to prevent unfair competition within a competitive environment between such tax-exempt entities and taxable businesses as may be engaged in certain kinds of common activity. The law does not impose any taxes on income derived by non-taxable organizations where such income is related to the exempt purposes of the organizations regardless of competitive considerations.

Mr. Chairman, the member systems of the American Healthcare Institute support the rationale that underlies imposition of the unrelated business tax. UBIT was not intended to have an effect on the tax-exempt status of qualified organizations, nor does it preclude such entities from engaging in certain kinds of activities. But, it is intended to impose comparable taxes on unrelated commercial activity that are comparable to those imposed on taxable entities. We think this is appropriate.

Throughout our nation's history, the voluntary, not-for-profit hospital has been accorded special status because of its commitment to a broad range of charitable purposes and essential community responsibilities. The goal of the voluntary community hospital is to maintain and improve the health status of all of the citizens in its community by offering whatever health-care services are needed, irrespective of whether or not the recipient can pay or whether the costs of such services can be recovered. The community service commitment of voluntary hospitals also frequently includes--in addition to providing personal health-care services--major responsibilities for the training of health-care professionals, the conduct of research to improve the quality of medical knowledge, and the health education of patients, their families and the community at large.

Prior to 1967, our hospitals met the cost of these commitments by a combination of federal and state project grants, the payment of billed charges from insurers and self-pay patients, annual community fund drives and philanthropy. With the passage of Medicare and Medicaid, patient care revenues were improved but other important sources of revenue, such as philanthropy, all but disappeared. Over the next few years, so also did most special federal and state project grants except for those destined for tax-supported and publicly sponsored institutions.

Despite these changes, our hospitals were able to continue to fulfill their community missions because their costs were reimbursed by both private and public third party payers. However, as a result of continued escalation of costs, in 1982 Congress changed the ground rules under which hospitals had previously operated when it passed the Tax Equity and Fiscal Responsibility Act (TEFRA) which had the effect of capping reimbursement.

In 1983, hospital reimbursement was changed even more radically when the Congress declared that, from then on, government would determine the value that was to be placed on services rendered in the hospital on behalf of Medicare patients and priced those services prospectively, thereby putting hospitals at risk in what was equivalent to a commercial marketplace. This approach received further endorsement when businesses in the private sector, who wanted their fringe benefit costs for health to reflect only the expense of their own work force, sought to purchase care directly at the deepest discounts possible. In other words, employers sought ways to pay only the marginal costs of taking care of their patients. It was as if these two principal purchasers of care, government and business, considered that health-care was to be treated like a commodity rather than as a social good.

To make matters even more difficult, every year since TEFRA, Medicare and Medicaid have been asked to absorb approximately 14% of federal budget cuts - even though these programs account for only 8% of federal outlays - thereby forcing many hospitals to transfer a portion of the costs of caring for Medicare beneficiaries to payers in the private sector.

Meanwhile, Mr. Chairman, even while their revenues are being constrained, we see no change in the attitude of the public as to what is expected of voluntary hospitals in pursuing their traditional missions. Indeed, in most communities the public still expects its local hospital to provide a full range of health services, irrespective of whether those services are economically viable, and to provide those services whether patients can pay for them or not.

In an effort to reconcile these conflicting expectations between purchasers, who wish to pay marginal costs for their beneficiaries only, and a public that expects us to meet all of its expectations for health care, how have our hospitals and physicians responded? Clearly, they have reduced admissions and their patients' length of stay. They have moved the treatment of every patient where it was medically appropriate into a less expensive, ambulatory or alternative delivery site. They have closed at the rate of approximately 45 hospitals per year (in 1986 this number was 83); have laid off over 180,000 employees, and reduced their capacity by over 70,000 beds.

Our hospitals also reorganized, corporately, to reduce their administrative costs. This permitted them to take advantage of the economies of scale that come from centralized purchasing and to tighten management capabilities and reduce overhead costs. Some hospitals also created not-for-profit and for-profit subsidiaries to generate new revenues to replace those lost as a result of the above-mentioned federal and private purchaser decisions. Among my own members, these entities have and continue to meet the same corporate tax obligations as other commercial enterprises. By and large, however, such ventures are not a major factor; indeed, to the best of my ability to ascertain, their earnings before taxes have never even reached 0.8% of gross revenues. From time to time our non-profit entities also engage in activities that involve unrelated business income and, in these instances, we pay such taxes as are required by law and regulation. Similarly, to the extent that I have information, such activities account for less than 0.3% of our gross revenues. The tax code therefore appears to strike an appropriate balance between the need to support the charitable purposes and community responsibilities of the voluntary, not-for-profit hospitals, while at the same time imposing appropriate taxation on unrelated business activities.

Having addressed the issues of unrelated business income, and our compliance with the code as it currently exists, I would like also to comment about competition. Unlike most nations in the world, human activity in the United States finds its outlet across three sectors: governmental or public, private or commercial, and the independent sector.

Our governmental sector includes the federal government, 50 states and approximately 83,000 local governments whose purpose, in the aggregate, is to undertake activities that meet the needs of people in those arenas where the people cannot meet such needs themselves; where the needs cannot be met from the commercial marketplace; or where there is a high concensus as to the desirability of rendering particular services.

The private-commercial sector encompasses approximately 13 million businesses. While these businesses produce products or services of greatly varying degrees of utility, it is their ability to make a profit in a competitive marketplace that characterizes their ultimate success or failure. Because they serve an essential economic purpose, they are subject to appropriate levels of state and federal regulations even while remaining under private control. If they make no profits, they pay no taxes. Generally, there are no constraints on their closing or withdrawing from business; indeed, they may come and go depending upon economic circumstances. They are further protected in that, if they are bankrupt, they are allowed to reorganize while being given protection against their creditors.

The independent sector in the United States, especially in terms of both it's breadth and depth, has been said to represent the soul of America because it serves as an outlet for caring, resourcefullness, creativity and personal involvement - encompassing activities that cannot be met on behalf of people by themselves and yet are not undertaken by government. It is a haven for early, non-profitable causes and for minority viewpoints.

The entities that make up the independent sector serve a social purpose because their benefits go to the community they serve. They are publicly accountable and locally controlled; are the outlets for virtually all voluntary efforts; and have access to philanthropy and less expensive capital because they have no way of returning earnings to investors. While charity may constitute an important part of the efforts of many of them, it is not a necessary part of their identity as long as they serve the public interest. Many have referred to the independent sector as constituting the research and development arms of society in view of the fact that much of its output is ultimately translocated into the private-commercial sector.

Because of their special contribution to society, independent sector entities enjoy special privileges such as exemption from sales, property and federal income taxes. By treating these institutions this way, government is able to protect them while not presuming to control them. Further, this special treatment permits such entities to raise capital in pursuit of their missions that couldn't possibly be raised if their objective was to make a profit. At the same time, these non-profit entities are ineligible for federal small business set-aside programs, small business Innovative Research Programs, loan guarantees, and direct loan programs. Parenthetically, it is the existence of the independent sector that permits the federal government to operate with a total tax and social security contribution from its people of less than 38% while virtually all other major industrialized nations pay between 52% and 65% because they centralize the distribution of so many of these services.

Why is this relevant to these hearings? It is impossible to meet all human needs across three such remarkable sectors without having competition at their margins. The governmental, independent and commercial sectors compete directly with one another in providing services to patients, the operation of health clubs, gift shops, subsidized parking, and restaurants. In recent years, the commercial sector has initiated competition with the governmental sector - and in a few instances with the independent sector - in areas that have been traditionally non-commercial as, for instance, adjudication services, the operation of fire departments, police and security services, jails, mail, couriers and the delivery of packages. As I have observed, most of these competitive expressions occur at the margins and are, with only certain exceptions, not necessarily central to the mission of any of the three sectors.

Within this context, competition between hospitals in the governmental, independent, and for-profit sectors already exists. However, because the general public continues to expect voluntary, non-profit hospitals to provide the services they need, irrespective of whether the services can be self-supporting or the patients can pay for them, and because society has moved the distribution of health care services into the commercial marketplace, thereby forcing hospitals to compete for patients by offering the lowest prices, it follows that generating new revenue to cover the cost of such activities as education, research, bad debts, indigent care, burn units, and neonatal intensive care has become essential.

Generally speaking, the criteria our institutions have used to determine whether or not to initiate a line of revenue-producing business are two. They include:

(1) Permanence and reliability. Hospitalized patients need such things as food, clean linens and medications. Hospitals need such things as billing and accounting services, safety inspections of new biomedical equipment, and emergency back-up electric generators. Such essential services are usually provided by the hospital to assure their continued presence. Private, for-profit sector entities produce goods and services for the purpose of making a profit for their owners or shareholders and, in this context, may come and go according to the dynamics of local and national marketplaces at any given point in time.

(2) Control and convenience. Meeting some patient expectations and needs can be sufficiently critical as to require that the institution guarantee the availability of certain services. Similarly, there are geographic and other circumstances wherein convenience must also be considered.

Initiating a revenue-generating activity for the purposes of permanence, reliability, control or convenience, leads some to conclude that not-for-profit hospitals have begun to resemble entities in the private-commercial sector. I would submit that very important distinctions remain, and that only an understanding of the full role of non-profit hospitals in society can put that issue to rest. In support of this proposition, I would offer the following points for your consideration.

First, voluntary hospitals almost universally trace their roots to ownership or sponsorship by a religious entity. As such, their missions were to meet a social purpose literally as an extension of government without being under governmental control. As stated by Lester Salamon, in 1987, "for better or worse, cooperation between government and the voluntary sector is the route this nation has chosen to deal with its human service problems. . .this partnership has deep roots in American history, testifying to its fit with basic national values. . .it is time to stop treating this partnership as an unwelcome relative and to recognize it as a more or less permanent, and quite valuable, fixture on the American policy landscape." Thus, the commitment of these institutions to meet the requirements of their communities, independent of economic considerations or the ability to pay, has been sustained throughout history.

Second, the economic cost of the tax-expenditures ascribable to voluntary, non-profit hospitals is incomparably low when compared to the economic value of their contribution. For example, 40% of all health expenditures are accounted for by hospitals. Assume that three-quarters of all hospitals are voluntary and not-for-profit; that their margins average 5% on gross revenue from all sources; and that all were to pay the full corporate tax rate of 34%. A maximum of $2.4 billion would be raised by the federal government if those institutions were not tax-exempt.

Third, together with many public hospitals, not-for-profit hospitals are the primary source of all clinical research, and all educational programs for health professional manpower including, but not limited to physicians, nurses, and other allied health personnel. There is insufficient capacity within the public hospital system today to accept all of these programs were they to be abandoned by the non-profit sector; nor would they be accepted by the investor-owned segment for reasons that are evident.

Fourth, many features are unique to the contemporary not-for-profit hospital. These institutions, for example:

(1) are located where they are needed - 75% are located in SMAs with the highest indigent patient loads - and currently provide 73% of all unsponsored patient care in the United States;

(2) meet the full profile of the health needs of their communities including, but not limited to, burn units, emergency rooms, neonatal intensive care units, rehabilitation and social services, health promotion and health education, etc.;

(3) provide the sites for the development phase of new technology;

(4) bring the convenience of health services as close as possible to those in need;

(5) historically and contemporaneously, have served as symbols of the healing arts; as standard setters for all hospitals; as sites for the examination of ethical

> conflicts between profiting from illness and professionally driven decisions; as outlets for personal philanthropy and voluntarism; and as sources of reinforcement for other community voluntary efforts such as museums, arts, culture, and education.

Finally, almost 30 years ago the American public first declared for itself the social aspiration that access to health care should be a right. By common consensus, there is no way in which government, today, can implement such a broad and desirable social objective. That government has been able to approach this objective has been wholly and totally dependent upon the existence of private, not-for-profit hospitals.

Mr. Chairman, it is our summary position that in a pluralistic and multi-faceted society such as our own, there will be both conflict and overlap between governmental, independent and commercial sectors. In other words, some competition is inevitable and may even be desirable. Reducing the competition to a reasonable minimum, consistant with permitting each of the elements of the three sectors to pursue their primary objectives is a proper objective. In this context, it is our judgment that the current Tax Code, while thought by some to be outdated in terms of the remarkable changes that have taken place in the environment, continues to serve us remarkably well. At the same time, we stand ready to refine, further clarify, and otherwise emend those points of contention that remain and will work with you and the members of your Committee to accomplish that objective.

Mr. Flippo. Mr. Lehrfeld?

STATEMENT OF WILLIAM J. LEHRFELD, COUNSEL, SHRINERS HOSPITALS FOR CRIPPLED CHILDREN

Mr. Lehrfeld. I am William J. Lehrfeld, and I have had the pleasure of serving as tax counsel to Shriners Hospital for Crippled Children for 17 years.

You may wonder why Shriners Hospitals seems to be the only member of the panel representing an individual hospital system. I will get to that in a minute.

I think perhaps Shriners Hospitals represents both the best and worst of what the concerns of the panels have been thus far.

In the worst sense we can undercut anybody's price because we don't charge any patients for any services or for any drugs or for any piece of equipment. Shriners Hospitals for Crippled Children served 16,000 children last year, as inpatients, and charged them nothing. We charged the Federal and State Government nothing. We charged insurance carriers and welfare plans nothing.

The best of it is that the Shriners Hospitals has operated since 1922 as a free hospital system for needy children under the age of 18 in the area of orthopedic diseases or defects and burns.

I brought with me our 990-T, along with details of the unrelated business income activities which we have.

I also brought patient census data so that if a Member from the State of Pennsylvania like Mr. Schulze, or the State of California, like Mr. Stark; or the State of Texas, like Mr. Pickle, is interested in the kind of costs incurred without reimbursement in hospitals in their States, we can provide it right now.

Last year we utilized the UBIT exemptions, the modifications in section 512(b) to earn in excess of $310 million on an endowment of approximately $2.5 billion.

The concern that we have is the statement in the September 12 press release where your committee asked, "Should passive endowment income be tax-exempt." We are here to say, yes, because we believe we make the highest and best use of tax-exempt passive investment income.

Shriners Hospitals for Crippled Children has no taxable or tax-exempt subsidiaries. The unrelated business activity which the hospital system has are inherited properties. We have farm properties; we have ranch properties; we have a walnut farm; we have oil and gas working interests. But each of those items have been inherited, none was purchased and none is subsidized by endownment income.

In 1986, we had $155 million in charitable contributions. $140 million of that came from death-time giving. All ordinary and some capital income is consumed—in 1986 we had an operating deficit of over $6 million, in excess of our noncapital investment income.

By the year 1990, the operating deficit will reach $30 million, by the year 2000 we will be encroaching on capital to the extent of $60 million a year for operating expenses. By that time, we expect to spend $400 million in capital construction and rehabilitation costs, and none of that will come from private or public borrowing.

We fully utilize the exemptions in the tax system, and we can suggest improvements for the charitable contribution incentives, which we use significantly. We strongly urge no change in the Federal income tax-exemptions, for investment income, such as dividend and interest income, and capital gain income. We do endorse and emphasize what we said in 1969; namely, that tax-exempt status should not be extended to gain competitive advantage over private enterprise for the conduct of private and business operations entirely unrelated to charitable purposes; exempt status should not cloak speculative business ventures, and funds destined for charitable purposes buttressed by tax-exemption should not be used to acquire or obtain commercial enterprises.

Thank you, Mr. Chairman.

[The statement of Mr. Lehrfeld and attachments follow:]

STATEMENT OF SHRINERS HOSPITALS FOR CRIPPLED CHILDREN CONCERNING TREATMENT OF UNRELATED BUSINESS ACTIVITIES OF EXEMPT ORGANIZATIONS

William J. Lehrfeld, Esq.

Lehrfeld & Henzke, P.C.
1101 Connecticut Avenue, N.W.
Suite 403
Washington, D.C. 20036

202/659-4772

Shriners Hospitals for Crippled Children welcomes the opportunity to offer its views on possible changes in the laws and practices governing the unrelated business income tax, as part of your Subcommittee's ongoing oversight of the financial affairs of the nonprofit sector. The Ways and Means Committee believes that certain aspects of the unrelated business income tax dealing with the exemptions of Int. Rev. Code Secs. 512(b) and 513(a) should be re-examined. Your Subcommittee is evaluating the adequacy of existing law to protect the public from possible abusive situations by the nonprofit sector in the ownership, management or operation of related and unrelated business enterprises.

The role today of Shriners Hospitals for Crippled Children is twofold: First, to exemplify the benefits returned to the community by a free hospital utilizing generic or specific tax benefits and incentives. In turn, you will be better informed about our hospital system and what harm could be predicted (or not) from the imposition of new taxes on endowment transactions. Shriners Hospitals, to that end, wishes to focus primarily on the Committee query posed in its September 12, 1986 press release:

> "What rationales underlie the various exceptions and modifications which permit tax-exempt organizations to engage in certain income-producing activities without taxation? For example, should endowment income be exempt from tax?"

The surmise may be that the original purpose for the exemptions to tax found in Secs. 512(b) and 513(a) has been obscured or superseded by the strength of the economy, low corporate tax rates, the laxity of enforcement by the Internal Revenue Service or generous interpretations of existing law in both administrative and judicial decisions. Any one of the foregoing may create the appearance of competition, and even unfair competition, between charities and commercial counterparts soliciting the same consumer for similar goods, services or facilities offered by each. We cannot perceive how a charity's endowment transactions create competitive frictions or frustrate any substantial federal public policy; but we believe if the question is asked, someone should answer. In our statement, we ask the Subcommittee to treat all endowment related transactions as tax free since the exploitation of passive investment opportunities, even using acquisition indebtedness, are not sources of unfair competition and are a traditional mode for supporting endowed institutions.

Secondarily, we also believe that part of the nonprofit sector's problems are of their own making by failing to be, or even appear to be, accountable to the public which so generously supports them through the federal tax laws. A complete revision of the reporting and disclosure rules is in order now, with special emphasis on all large exempt organizations, including religious societies. If the Congress wants to tighten the tax rules governing various forms of related and unrelated business enterprises, it should give the charitable community something in return, viz, enhanced incentives to taxpayers to make lifetime or death time gifts of money or readily marketable property. We have attached to this statement a list of changes -- some minor and some major -- in the area of charitable giving -- which could balance the revenue loss you plan to create by your future actions.

A.

Shriners Hospitals for Crippled Children earns no income from its exempt function in that it is a completely free hospital system offering medical care to children under the age of 18 without any charge whatsoever to the children, the parents, or any third party insurance carrier. It receives no federal financial assistance, in any form, except for the incentives and benefits enjoyed under the Internal Revenue laws. Its operating expenditures, approximating $153 million for 1987, are supported entirely by earnings on its substantial endowment. Gifts and bequests made to Shriners Hospitals for Crippled Children are assigned to the endowment as a matter of corporate policy. By assigning all gifts and bequests to endowments, Shriners Hospitals for Crippled Children is able, unlike many other public institutions, to build new hospital facilities, or refurbish existing plants and equipment, entirely from its endowment without borrowing funds from the private or public sector for such purposes.

Let me take a moment to inform you of the financial and medical affairs of Shriners Hospitals. In 1987, the operating budget is $153 million for 22 hospitals, containing a total of about 1200 beds. Less than 4 percent of this sum is spent on investment management, fund raising and overhead for our Tampa headquarters. The equipment and construction budget is an additional $32 million and the research budget is an additional $14 million, meaning budgeted expenditures of $199 million for 1987. This is not entirely representative of the services rendered children in the past since our organization has expended only $1.2 billion, in operational costs, since the first Shriner Hospital was opened in Shreveport, Louisiana in 1922. In addition, only $246 million has been spent in construction costs for the 22 hospitals to date. In sharp contrast, up to the year 2000, Shriners Hospitals is committed to capital expenditures of upwards of $380 million on the construction, re-construction, renovation and rehabilitation of existing hospital facilities.

In 1986, almost 135,000 children were seen on outpatient basis, 14,000 children were admitted to our 19 orthopedic units and 2,000 children were admitted to the three burns units. Over 300,000 children have been admitted, free of charge, to all hospitals since the first hospital opened. Our records do not disclose historic outpatient data but we believe the number of such visits is very significant.

In 1986, our organization had passive income of $129 million, net of professional management fees and expenses, consisting almost entirely of interest and dividends. Unrestricted gifts and bequests from the public were in excess of $140 million and realized capital gains from routine endowment management was in excess of $150 million. The market value of our endowment, on December 31, 1986, amounted to approximately $2.321 billion. All of this information is reported on our I.R.S. Form 990, and on financial statements furnished the Better Business Bureau and other regulatory agencies.

Despite this wealth, the increase in costs of providing hospital, medical, surgical and outpatient treatment will shortly dwarf the earnings from this endowment. Our financial officers predict, by 1997, that we will be invading capital to upwards of $60 million annually to maintain the same or better quality care in the 22 hospitals. Despite these cost overruns, there simply is no likelihood, none whatever, that Shriners Hospitals for Crippled Children will change its fundamental policy of providing totally free hospital care for children in need.

The deficits which we have projected based upon the experience to date in our 22 hospitals, makes our concern over the possibility of the taxation of endowment transactions even more acute than it would be if we were simply operating on a "break even" basis. Because the Congress will evaluate the worth of the exemption of passive investment income from unrelated business income tax under Sections 512(b)(1), (2), (3) and (5), we feel absolutely compelled to present our case for the continuation of this exemption. The use of tax free endowment earnings for the public benefit is the highest and best use of such income. Public benefit should be the primary measure for the entire exempt organization community since we see little or no justification for the use of such funds in active, unrelated business activities.

At the present time, Shriners Hospitals for Crippled Children does not engage in arbitrage transactions, invest in future contracts, make short sales, offer puts or calls or any other types of sophisticated investment strategies. Perhaps the day may soon come where it must look to an upspeed form of money management to enhance its total return; but at the present time, its investment strategy is simply to find prudent investments useful for long term income production and appreciation, and utilize the investment skills of professional money managers.

B.

In 1942, the late Randolph Paul, serving then as Assistant Secretary of the Treasury, suggested to the Committee on Ways and Means that it evaluate the possibility of taxing exempt organizations on their business income which was "unrelated" to their exempt function. Partly in response to this suggestion, the Congress, in 1943, enacted the first statutory authorization for exempt organization information returns. These returns were filed and analyzed in a 1945 Treasury, Internal Revenue Service and Joint Committee project later made available to the Congress. In 1948, the Congress attempted to enlarge the coverage of the exempt organization filing requirement but no legislation was passed and the matter carried over to 1950. With the passage of the 1950 Revenue Act, imposing the unrelated business income tax, Congress also concluded that disclosure of these returns would have an enforcement effect.

We believe that what occurred in the past is a signal to the Congress of what should occur in the near future: Before any significant substantive changes are recommended for statutes governing the taxation of unrelated business activities, the Congress should strengthen the information return reporting, collecting and disclosure rules. Coterminously with any such legislative recommendation, the Treasury Department should, by forms or regulations issued under Sec. 6033, gather its own preliminary information about the business income of exempt organizations now required to be reported on Form 990. In a joint effort, the Congress and the Treasury Department could then inform itself and the public on the amounts involved, the type and size of enterprises and the ends accomplished by the receipt of exempt business income. To do otherwise would represent a premature, and unfortunate, circumstance since the Congress ought not legislate in the unrelated business income tax area without having detailed information about the probable value and likely affect of its actions.

C.

Shriners Hospitals has no taxable subsidiaries. We do not invest in unrelated business enterprises -- although we do inherit some. It is firm corporate policy to promptly sell any such gifts at the best price possible.

The issue of subsidiaries and corporate business affiliates has dogged the nonprofit sector for years and many devices were used to exploit a charity's tax exemption. The lack of constant vigilance in this explosive area is due in large measure to the way Internal Revenue Service audit programs are designed. Rarely, if ever, do audits of exempt organizations include the tax issues prevailing in relationships between the subsidiaries or the controlled affiliates and the exempt organization. We believe that the controlled organization provisions of Section 512(b)(13) need your immediate attention. There are just too many ways in which an exempt organization can by-pass the restrictions contained in that remedial legislation. In all likelihood, many if not substantially all controlled taxable subsidiaries which are particularly profitable are arranged under a 79 percent control circumstance which permits full deductibility of the upstream payment of royalties, rents, interest, etc., and yet treats as tax free these same amounts when received by the controlling organization. The ease of manipulation of this particular provision is obvious and no amount of related party rules can override a statute that is strong in its intention but weak in its delivery. Internal Revenue Service complaints on this score should be addressed by the Subcommittee. Perhaps the Congress should approach this question by making the deductible payments by the controlled organization taxable to the parent to the extent of its ownership interest in the controlled organization, where the controlling organization owns 40 percent or more of the voting stock, regardless of the total value of the stock outstanding. The unrelated business tax liability of the controlling organization would then be first limited by the fraction created under existing law (unrelated business income to taxable income) and then that amount would be further limited by the fraction which the controlling organization's voting share represents in the total outstanding voting control of the organization. In no event, however, should there be a tax liability accruing to the controlling organization where the controlled organization is operating at a loss, computed without the deductible payment.

We do not believe that the Congress should extend the rules of Sec. 4943 to public charities unless its later investigations prove that too much energy and too many resources are being devoted to for profit enterprises by the Sec. 501(c)(3) community.

Congress chose to tax the investment income of social clubs and employee beneficiary associations in most respects except for amounts dedicated to charitable or insurance purposes. Congress has not, however, reasoned why labor unions, trade associations, and other self interested cooperative organizations should enjoy their investment income tax free. To the extent that these organizations perform important public services, then the receipt of investment income is perhaps appropriate, but to the extent that such organizations are merely increasing the profits of profit making entities by reducing the level of support which the business organizations must otherwise supply to a trade association or union, then the policy for a general exemption on investments deserves to be addressed and re-evaluated. Obviously, if the amounts involved are not significant, then the Congress should not expend its limited energies in re-evaluating this topic; but without knowing the extent to which certain membership organizations are subsidizing business programs of profit making enterprises, it cannot fulfill its oversight task. Likewise, you have no way of knowing how much tax free income from related business activities capitalize or subsidize unrelated business activities.

We believe the Treasury Department, using existing line items on Form 990, should volunteer to tell Congress of the value of the subsidy to private mutual organizations. You could also use questionnaires to determine, by exemption classification, the extent that such income is used for charitable, educational or scientific purposes and when its used for business purposes. This task may take some time -- assuming the mechanics for its collection and collation are available -- but the Treasury Department's open commitment to do so would send the right signal to the right parties.

It might also be worthwhile for the Congress to codify the rule established by several circuits that alleged charitable contributions by a controlled subsidiary are not deductible for income tax purposes when paid to the controlling organization. The tax policy suggesting this limit on the charitable contribution deduction would further the obvious and desirable role of creating a distance between commercial business aspects managed by charity and their philanthropic responsibilities. There is, even today, substantial merit in some of the recommendations limiting the opportunities for business entrepreneurship contained in the 1965 Treasury Foundation Report.

D.

The unrelated business tax should tax regular, income producing activities "not substantially" related to the exempt function of the sponsor. The regularity test remains an appropriate one and we believe its value to the exempt organizations community could be enhanced by some clarifying administrative rules. We do not believe that unrelated, but irregular, business activities are either a source of unfair competition or a significant revenue loss. They can prove to be a modest, yet fruitful, source of funds without any real market dislocations.

E.

What deserves thoughtful re-evaluation, in its entirety, are those provisions of Sec. 512 and 513 which now exempt from federal income tax regular, commercial, and profitable unrelated business activities deemed to be related by law. These exemptions often create significant anticompetitive effects, entail significant revenue losses, and negatively pervade the public's perception of the real value and purpose of charitable institutions. An exempt organization may conduct an unrelated business in the following format and pay no income tax if:

(1) The unrelated business is one in which substantially all the work is performed for the organization without compensation;

(2) The unrelated business, is one which, if conducted by a Sec. 501(c)(3) organization, consists of selling goods, services or facilities to an organization's members, students, patients, officers or employees;

(3) The unrelated business is one which sells merchandise to the public received as gifts or contributions;

(4) The unrelated business consists of a trade show, state fair or qualified public entertainment activity;

(5) The unrelated business involves the performance of certain administrative hospital services for small hospitals;

(6) The unrelated business is bingo;

(7) The unrelated business involves the distribution of low cost articles while soliciting contributions, or the rental or exchange of an organization's donor lists;

(8) The unrelated business consists of research for the United States, its agencies or instrumentalities or involves research for any state or political subdivision;

(9) The unrelated business, when conducted by a college, university or hospital, consists of research performed for any person;

(10) The unrelated business, if conducted by a fundamental research organization, consists of any research activity; and

(11) The unrelated business involves insurance services for or on behalf of veterans' organizations.

In each of the above exemptions, there may be related business activities making the express exemption superfluous. For example, trade show income earned by Sec. 501(c)(3) or Sec. 501(c)(6) organizations, is quite often from an activity clearly and closely related to the exempt function of the sponsoring organization but, for reasons known best to Congress, is expressed in a specific exemption.

On the other hand, certain exempted activities are almost always unrelated to an exempt function of the sponsor and could rarely, if the special exemption was removed, be treated as a related business activity. For example, one would be hardpressed to develop any circumstance which would treat bingo as related to any organization's exempt function. Bingo is probably exempt because of the political strength of the users and the fact that the revenue loss was not thought to be significant. It doesn't appear to have any enhancement of social values rationale.

Whatever reason Congress had in 1950 (or later) to exempt these businesses deemed related, the continuing value to the public of these exemptions is based on much speculation and few facts. We are certain the Congress does not have adequate information from available sources to indicate the amounts of unrelated business income exempted by existing law. We are also certain that the Internal Revenue Service doesn't have any information either and if it did, doesn't have the capacity to pull it together in a meaningful, timely manner. As a consequence, we recommend that the Internal Revenue Service be instructed to create specific form(s) to be filed (e.g., for 1988) by all large organizations apparently affected by these exemptions. The special schedules for Form 990 would ask for an identification of amounts of income (e.g., aggregating $1,000,000 or more) derived from the Sec. 512(b) and 513(a) descriptions, even if such income could also be deemed "related." By requiring specific disclosure of substantial revenue generating activities, deemed by law to be related business activities, the Internal Revenue Service will be gathering useful information about major exempt organizations. This will enable the Congress perhaps in 1990 or later to determine whether it wishes to continue each and every existing exemption, or narrow or enlarge them, or ultimately require all business revenues to in fact be "substantially related" to the exempt purpose or function of the organization.

We recommend that no such specialized schedule be demanded of any exempt organization unless gross revenues from all sources of the organization exceed $5 million and the gross income from all the 512(b) or 513(a) exemptions aggregated $1,000,000 or more. We also believe that these special schedules should be furnished directly to the National Office, as well as being part of Form 990, so that statisticians in the National Office can prepare promptly a comprehensive survey of the results.

F.

The public has only apparent and not real access to information about the finances of exempt organizations. Treasury and the Congress have already concluded that the public deserves to know more about how all exempt institutions serve themselves and their communities. Organizations which enjoy an income tax exemption and other tax incentives or subsidies (including special postal privileges) should be accountable to the public, by timely availability of meaningful documents and through disclosure of actions of Government agencies conducting oversight tasks. But as is well known throughout the Congress, the press, and the Internal Revenue Service, the public knows little about the exempt organization arena since gaining access to "public" statements of financial condition (i.e., IRS Form 990) is a time consuming and frequently unsuccessful exercise. Successfully invoking Sec. 6104(b) yields information which is often incomplete, usually untimely and frequently illegible. As a mechanism to restore the public's confidence in the exempt organization community, and to provide a basis to re-evalute existing exemptions, the Congress should enact a statute which requires all large exempt organizations, including churches, to file a LEONOR, a large exempt organization National Office return, if gross receipts from all sources exceed $50 million per year. These returns could be designed solely for public disclosure use and available for public inspection on an immediate basis. The returns should contain information about passive and active business opportunities enjoyed by large exempt organizations which would permit the public to determine if the extent of the exemption and deduction subsidy continues to be worthwhile.

We also believe that all Sec. 501(c)(3) organizations should be required to make their Forms 990 directly available to the public (for a fee) upon request, similar to the rule now in effect for private foundations. We also believe that Sec. 6104(a) should be amended to require disclosure of all administrative records about an organization relating to its exempt status, on file with the Internal Revenue Service. Under existing law, only documents related to an exempt organization's original application are disclosed -- and nothing subsequent thereto -- including later audit actions or possible revocation actions. As presently drafted, Sec. 6104(a) is largely useless and should be revised so that current administrative information in Internal Revenue Service files about exempt status is available for public disclosure. This, of course, requires the Internal Revenue Service to maintain its records to assure the public that an up-to-date administrative record is available without undue delay.

G.

Part of the difficulty confronting the public today, and the managers of exempt organizations, is the lack of a credible enforcement effort of existing law by the Internal Revenue Service. Examinations of exempt organization affairs have been increased, perhaps to the level of 20,000 examinations per year. This level, approximating two percent of the exempt organizations returns filed, is not representative of prior years nor can it be sustained without some corrective efforts by the Congress to increase staffing and funding for Internal Revenue Service auditors who devote themselves exclusively to the exempt organizations area. We believe the Treasury Department should be pressed to seek higher appropriations for more exempt organization auditors and existing law be amended to allow the Internal Revenue Service to charge certain user fees to make major audits pay their own way. Your Subcommittee's analysis of the auditing problem could inure to the benefit of your colleagues responsible for the authorization and appropriation process. But we would strongly oppose any semblance of the 1 percent or 2 percent alleged "audit fee" tax now applied to private foundation endowments since far too much money would be raised -- and with little assurance that even a modest portion would go to subsidize the examination and oversight role of the Internal Revenue Service.

From our review of the IRS Exempt Organizations Audit Handbook, a part of the Internal Revenue Manual, and from other sources, it appears that the Internal Revenue Service field agents and office auditors lack a comprehensive audit planning guide for organizations with related and unrelated business income. It seems that the selection for audit and the resultant examination of major exempt organizations should not be as haphazard as it appears; a comprehensive and standardized audit format should be created for each exemption class (or divisions within classes like FASB guidelines) to assure the fairness of the audit, its completeness and its integrity. A uniform audit format could be prepared, with the cooperation of the public, the exempt organizations community itself, tax scholars and professionals serving the exempt community. We believe that if the Internal Revenue Service is pressed by the Subcommittee for a commitment on such a project, its actions would bear fruit in less than a year. Now that the Internal Revenue Service has created an Exempt Organizations Advisory Group, a vehicle exists to bring the public into exempt organization administration. To make the group more valuable, Sec. 6103 should be amended to coincide with a liberalized Sec. 6104 so that all types of exempt organizations matters can be freely discussed.

H.

In sum, information is not presently available to the Congress to undertake wholesale revision of the all of the rules governing the application of the unrelated business income tax. Although there may be instances under existing law where exemptions are being abused, these can be corrected promptly through patchworking. We think the Congress should not act in a precipitious fashion in response to allegations of unfair competition by the private sector. The clamor by certain segments of the public sector to tax all competitive (but related) exempt organization enterprises is not justified when there has been no full and fair exposition of pertinent facts. Important tax policy decisions affecting charities should unfold as information develops and is analyzed. Creating a statutory mandate for complete and timely financial disclosure, requiring Governmental research and analysis of available data, and then further public review thereof would enable both Treasury and the Congress to judge whether or not certain unrelated, but exempt, business activities are still justified. The Congress and the public deserve to know rather than guess at what needs redress. But even with better laws on reporting and disclosure, Congress should demand better work from the Internal Revenue Service; the Internal Revenue Service should demand better cooperation from the nonprofit sector; and the nonprofit sector should demand of its own a better understanding of and appreciation for the privileges and immunities the public has bestowed.

Attachment A

SUMMARY OF
SHRINERS HOSPITALS FOR CRIPPLED CHILDREN
LEGISLATIVE PROPOSALS

1. Amend Sec. 512(b)(13) to tax rent, interest and royalty income from any taxable affiliate or subsidiary received within a control group, where there is effective voting control in excess of 40 percent; liability would be proportionate to effective voting control of the controlling organization within the controlled group.

2. Amend Sec. 6033 to require separate schedules for all active forms of unrelated business income, deemed related by law, where entity's gross receipts are in excess of $5 million annually.

3. Amend Sec. 6033 to require all large exempt organizations, including churches, to file a public financial statement with the National Office which can be released immediately to the general public.

4. Amend Sec. 6104 to require that all Sec. 501(c)(3) organizations make available to the public, for a fee, their IRS Form 990, with special exceptions for small organizations.

5. Amend Sec. 6104 to require that an exempt organization's entire Administrative Record, and not merely the exemption application, be maintained by the Internal Revenue Service on a historic basis for purposes of full disclosure to the public. Sec. 6110 should be amended to require that all Internal Revenue Service rulings and technical advice on exempt organization matters are disclosed.

6. Statutory authorizations and appropriations should be made specifically for exempt organizations' oversight and auditing.

Attachment B

SHRINERS HOSPITALS FOR CRIPPLED CHILDREN PROPOSALS FOR ENHANCEMENTS OF CHARITABLE GIVING UNDER EXISTING LAW

Suggested changes contained herein are not in any particular order of importance to the proponent and certain provisions are included primarily for discussion purposes without any significant evaluation of the revenue losses associated with same.

1. The percentage limitation on contributions of cash to public charitable organizations should be extended from its current 50 percent to 60 percent of an individual's contribution base.

2. The percentage limitation on contributions of cash by corporations should be extended from 10 percent of taxable income to 20 percent of taxable income.

3. The percentage limitation of charitable contributions made by organizations subject to unrelated business income tax should be 20 percent of unrelated business taxable income (cf. Sec. 681(c)), without regard to the form of the exempt organization.

4. Sec. 170(c)(4) should be amended to delete the phrase, "in the case of a contribution or gift by an individual" to authorize charitable contributions to be made to fraternal societies, when used thereafter for charitable purposes.

5. Sec. 170(b)(1)(A) would be amended so that no percentage limitation would be applied in the year of the death of an individual for contributions made that year or in prior years.

6. With respect to a contribution to a state, or political subdivision thereof, for hospital or medical purposes, no percentage limitation would apply either in the case of contributions by individuals or by corporations under Sec. 170(b). States would be expected to set up legislative funds to receive such contributions for distributions to hospitals within the state.

7. The rules governing carry forwards of excess contributions should be amended to permit carry forwards for ten taxable rather than the existing five taxable years in the case of both individuals and corporations.

8. Sec. 170(f)(4) should be repealed so that the valuation of a remainder interest in real property is governed only by the value of the private beneficiary's estate in the remainder property.

9. Sec. 41(e)(6), defining qualified organizations eligible to receive contributions of scientific research equipment, should be expanded to include hospitals which carry on research activities (but which are not primarily the purpose or function of the hospital organization).

10. Sec. 155 of DEFRA (1984) should be amended to provide that no appraisal is necessary with respect to a gift of property subject to the appraisal rules if the property gifted is sold by the close of the first taxable year after the transfer and the donor agreed, to use the sale price realized by the charity as the measure of the charitable contribution deduction.

11. Sec. 642(c)(2) should be amended to delete the charitable deduction requirement for trusts and estates that any payment made for a charitable purpose must be made "pursuant to the governing instrument."

12. Sec. 663 should be amended to clarify that distributions to charitable remainder trusts establishing the corpus of charitable remainder trusts are deductible in the computation of the estate's distributable net income.

13. Sec. 57(a)(6) should be repealed, which now includes as an item of tax preference the extent of appreciation in a contribution of capital gain property to a public charity.

14. In lieu thereof, in determining the extent of appreciation to be included as an item of tax preference where a remainder gift of appreciated property is made to a charity, and a coterminus gift is made of a private life estate, the actuarial reduction for the value of the life estate should first be applied to the appreciation element of the appreciated property, and then lastly, to basis.

15. Sec. 642(c)(5) should be amended to fix the valuation of the remainder interest in pooled income funds at 5 percent (and never higher) where the pooled income fund is completely under the dominion and control of a public charity.

16. Sec. 642(c)(5) should be amended to allow pooled income funds to be created for term of years, similar to the rules in effect for charitable remainder trusts.

17. Valuation rules for remainder gifts to charity involving life terms should be altered to remove actuarial factors if the death of an income beneficiary prematurely terminates his or her interest in the charitable remainder trust. In this suggestion, death could be treated as a disclaimer where the death of the income beneficiary occurred within the due date for filing of, for example, the federal estate tax return.

18. Sec. 664(c) should be revised to preserve the tax exempt status of charitable remainder trusts even where there is unrelated business income; and unrelated business income can be taxed as if earned by a Sec. 501(c)(3) trust, subject to the right to take a charitable deduction for the amount paid or set aside for charitable purposes.

19. Sec. 7428 should be amended to permit declaratory judgment challenges to any disallowance of part or all of a charitable deduction under Sec. 170(b) or (c) by the nonprofit organization adversely affected by an I.R.S. determination.

20. Six percent interest tables should be restored through 1995 and would not be increased unless prevailing interest rates were 150 percent of the rate prescribed by statute.

21. Secs. 7421 and 7428 should be amended to authorize public charities to participate in classification determinations involving charitable trusts and other charitable organizations which are operated, supervised or controlled by or in connection with public charities. There are many instances in which a public charity will wish to have an affiliated organization treated as a private foundation in order, for example, that the self dealing rules be applied to protect the corpus thereof while there are other instances where the public charity should have the opportunity to argue, either directly or as an amicus, that the affiliated charitable trust deserves to be treated as a Sec. 509(a)(3) organization.

22. Sec. 4947(a) should be amended to clarify that any part of an estate destined for a charitable beneficiary, including a charitable remainder trust, pooled income fund or private foundation, may be subject to the self dealing rules of Sec. 4941 during the period of its administration.

23. Sec. 501(m) should be amended to exclude from unrelated business income tax charitable gift annuities described in Sec. 514(c)(5).

Mr. FLIPPO. Mr. Seay.

STATEMENT OF J. DAVID SEAY, VICE PRESIDENT, SECRETARY AND COUNSEL, UNITED HOSPITAL FUND OF NEW YORK

Mr. SEAY. I am J. David Seay, and I am vice president, counsel and corporate secretary of the United Hospital Fund of New York, the Nation's oldest federated charity. For 108 years our organization has been involved in philanthropy, information, and public policy research and formulation in health care in New York City. I thank you for the opportunity to appear here today to present our views, which are relatively independent but decidedly pro-voluntary, about competition between not-for-profit organizations such as hospitals and for-profit businesses. My comments will focus primarily upon the taxation of unrelated business income of charitable organizations.

I would like to make two points today. The first involves the public policy rationale underlying the tax-exempt status of charitable organizations, and the appropriate role of not-for-profit charitable hospitals in our society. Second, I will offer a few simple recommendations for action that should adequately address any real abuses of the sort that we have heard about and which undoubtedly exist to some extent.

With regard to the policy issues, I would like to speak to the allegations that some nonprofit voluntary hospitals are inappropriately expanding into areas of patient care and patient service that are best left up to for-profit businesses. I suppose that these activities could include almost anything in addition to the inpatient acute care hospital bed itself, and the services directly related to an inpatient hospitalization. However, many of the new ventures and so-called lines of business into which hospitals have entered in recent years represent activities in which both public health experts and public officials have long urged greater hospital involvement.

To exhort hospitals to enter into new outpatient services and clinics, home care, retail drug and equipment distribution, and so forth, in order to promote more vertical integration of health services or greater efficiency in health care management, and then to immediately turn around and criticize hospitals for unfair competition strikes us as both unreasonable and ill-advised. From a public policy point of view, we believe that patients, and society, as a whole, are better served where there exist nonprofit voluntary community hospitals that are not only capable of, but also encouraged to provide a continuum of care to their patients and their communities, thus affording better continuity of care, better managed care, and improved health services.

Even more basic to the question of unrelated business income of tax-exempt organizations, is the tax-exemption of the organization itself. We feel very strongly that a sound and compelling case can still be made—perhaps even more now than ever—for the continued existence and public policy approbation of tax-exempt, voluntary, not-for-profit hospitals and other health care institutions, so long as those institutions continue to live up to public expectations to provide community service. And it must be pointed out that community service is a multifaceted concept, defined in many ways, not the least of which includes the over $22 billion dollars in charity care given to indigent patients by the Nation's voluntary hospitals over the past 5 years.

But there is a lot more to community service than just charity care. In order to be around to give community service, whether it is uncompensated care, medical education and training, community outreach programs to all segments of the population, valuable biomedical research, or any of the other attributes of voluntary community service, the institution must be able to stay afloat. Very few of the voluntary hospitals with which we are familiar even engage in what any reasonable person would call unrelated business, and those few that do, do so simply to be able to continue to support their basic charitable missions. Even then, we feel that the unrelated business income tax law is basically sound, and that the profits made from such enterprises that are unrelated should be taxed, as the law now requires.

It must also be emphasized that many of the activities in which hospitals engage are not inherently or continually profitable; not-for-profit hospitals have many motives for developing new services. Thus, any expectation of significant revenue gains from greater taxation of profits in the voluntary sector is likely to be disappointed.

The second major set of points that I would like to make today involve recommendations for improvement of the current law and its implementation. Although we feel that the basic concept of the unrelated business income tax law is sound and should not be destroyed or radically altered, we do feel that any abuses that might exist can be addressed by the following four recommendations: information, enforcement, disclosure, and cooperation.

By information I suggest that a systematic study of the extent and nature of both related and unrelated business activities of charitable organizations be conducted, so that national tax policy can be intellectually sound and based on an educated process rather than upon anecdote. The Internal Revenue Service is currently conducting a study from data obtained from the 990-T forms for just this purpose, and the committee and the Treasury may wish to consider the advisability of improved and more detailed reporting requirements.

Regarding enforcement, a number of steps can be taken. These include improved audits and audit guidelines for field agents and other officials of the Internal Revenue Service are needed. Also, this committee, working with the Service and the charitable sector, can and should develop clear criteria for the relatedness test of business activities. Clearly, more explicit statutory standards, or at least administrative guidelines, are needed to guide the Internal Revenue Service in its treatment of unrelated business income. Such standards should focus on the statutory or charter expression of purpose of the organization being reviewed, and the relationship between the reportedly unrelated income and the institution's purpose or mission. A clearer understanding and better enforcement of this concept will go a long way, in my opinion, toward clearing up many of the misconceptions and problems that have brought us here today, by exploding some myths in many cases and by deterring abuses in others.

Recommendations for improved disclosure involve both improved reporting and disclosure to the Government as well as better public access to information about nonprofit charitable organizations. For example, public availability of the 990 form, as is already required of private foundations, could be required of all charitable organizations, so long as lists of donors are not included. Also, the committee may wish to consider the example set by the State of New York in requiring that the 990 form be filed with the State, made part of the public record, and available for inspection.

And finally, we applaud the steps that have already been taken toward better cooperation between Government and our sector. Specifically I refer to the June 3 announcement by the Internal Revenue Service of the formation of an Exempt Organization Advisory Group.

I appreciate the opportunity to testify today on behalf of the United Hospital Fund, and I would be glad to answer any questions.

Thank you.

Mr. FLIPPO. Thank you very much, all of you for your testimony.

We will of course include your entire statement in the record. In an attempt to try to really identify the main issue that we are struggling with here, it appears to me that the main issue is should there be limitations on the activities are nonprofit organizations, whether the commercial activities of both traditional and nontraditional that you engage in, should they be taxable? Should there be a limit on the amount of commercial activity that hospitals engage in?

That is a quorum call now, we will continue for a few minutes and then recess.

But that is really what we are trying to probe. Should there be a limitation on what you are doing?

Mr. Leech, you are an attorney and indicated to us at the beginning of your testimony your experience in this area. What limitation do you think you have on your organization to engage in traditional and nontraditional activities?

Mr. LEECH. Mr. Flippo, in the tax code as it presently stands, while it may be general in a sense, it does say that you are permitted to enter into those activities which further the tax-exempt purpose of your organization. To the extent that other activities that are not substantially related to that exempt purpose are entered into, you run the risk of destroying the tax exemption that you have.

While that is a general statement, it has been applied, I believe very effectively in the health care industry, mainly because you need flexibility. This is a new reaction that the health care industry has to the demands being placed upon it. To put any specific limitations, percentage of such income that can be earned for instance, across the board would have, I think a great dislocation on an already pressured industry.

So I feel there are definitions there and it may be a matter of enforcement.

Mr. FLIPPO. Well, Treasury has suggested to us that as more and more activities are entered into and revenues derived that at some point perhaps we should try to understand whether or not the primary function of the tax-exempt organization has changed. At what point? Is there any point? Suppose your revenues are 200 or 300 or 400 percent—how far can you go? Do you have any suggestions for us as to when we decide that your primary function is something other than the purpose for which you enjoy tax exemption?

Mr. LEECH. It is my understanding that the rule of thumb now used—this is not written into the statute—the rule of thumb is that to the extent that 20 percent of your revenues are generated from totally unrelated activities, that you run the risk at that point of not substantially acting in furtherance of your tax-exempt purpose and could lose the exemption. I don't know whether 20 percent is good or bad. I can tell you from experience that I know of no hospital system, either nonprofit single hospital or group of hospitals, that comes anywhere near that as far as unrelated income is concerned. I don't know that there is a magic number you can put on that.

Mr. FLIPPO. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

Mr. Leech, I want to set up a couple of hypotheticals for you because you have been in the practice of representing the nonprofit hospitals so you have done a lot of the legal work. You have an illustration where the previous panel said they were in private business. Some of them providing transportation through taxicabs, one telemessaging through electronics. We had health and durable medical equipment. Let's say that your client comes to you and asks you for advice. You could tell them that they could do that within the confines of their tax-exempt organization and they could actually go into the business. That portion that would be considered unrelated would have to be identified, it would have to be reported if it goes over a thousand dollars on the 990-T form, correct?

Mr. LEECH. A thousand dollars is correct. I am not sure about your first premise. But go ahead.

Mr. ANTHONY. So your clients went into the business of providing these services?

Mr. LEECH. If it was to provide DME as they call it, to patients that were totally unrelated to the hospital system, there is some question as to whether or not that would fall within the tax-exempt purpose of that specific hospital system. My advice to them would be to set it up in a for-profit corporation, separate entity and pay tax on it.

Mr. ANTHONY. I am glad you answered the question that way because it jumps me to my next series of questions. Under the current Tax Code, if that taxable organization were housed in a building then your not-for-profit organization could charge them rent, correct?

Mr. LEECH. Right.

Mr. ANTHONY. That would be a deductible item that would come off of any revenue from the taxable organization?

Mr. LEECH. Correct.

Mr. ANTHONY. You could also charge them interest on any money loaned. You could transfer dividends out of that taxable organization into the nontaxable organization. Those dividends are then not taxed through the nontaxed entity.

You could also set up a royalty system and you could transfer royalties.

My point is this, with all the pressure coming—and it looks like without question there is a trend there, Mr. DuVal pretty much established the fact of the trend there—it seems to me the Tax Code is just absolutely full of loopholes whereby this is a taxable organization—and you are bragging about setting up a taxable organization—but you are able to deduct from income that would be taxed, you are able to just deduct all these things. So what is your response to that, the fact that you can deduct all these things and the fact that the law is very loose on what is a controlled subsidiary?

Mr. LEECH. To the extent that you are taking those deductions, you are also a for-profit corporation totally unrelated to a tax-exempt entity, it has certain deductions it can take.

I think you lose sight of the fact that if in fact this operation is to be created by a tax-exempt entity, it is created for a single purpose and that is to make money. So it will be operated in a fashion where it can make money. There may be advantages that it can receive——

Mr. ANTHONY. Let me interrupt you there. Say I am in competition with you across the street. I have to pay higher interest. I can't deduct the dividends. I can't deduct royalties. I can't deduct the rent in the way that it would be transferred over to a parent company and all of that is received as a source of revenue and nontaxed.

Yet it is an expense to the taxable organization.

It just appears to me that the previous panel may be telling us that there is a fox in the chicken coop here.

Mr. LEECH. You realize that the tax-exempt entity that set this up has lost any tax advantage it has as well to operate as a normal investor would. Losses cannot be set off.

Also I think it is common that in smaller businesses the investors if they are a single individual or small group of individuals try to pay themselves in ways other than dividends, higher salaries, whatever, and I think that they have advantages that also are just unavailable to a tax-exempt entity itself.

Mr. ANTHONY. I am going to reclaim my time. Mr. Chairman, I have a series of questions to this panel on this particular issue, and I would ask permission to submit those questions to the gentlemen in writing.

Mr. FLIPPO. I might say to the gentleman from Arkansas we will ask our panel to wait for us. We will need to take a very brief recess and go over and vote. Several members of the panel of the committee are very interested in your testimony and have questions for you.

Mr. ANTHONY. Just one final comment, unfortunately I am also on the Health Subcommittee and the Health Subcommittee is in the process of marking up the budget reconciliation legislation right at this moment. That was the phone call I just received saying they are taking a recorded vote.

I will not be able to come back. I will have to stop off and go to that Health Subcommittee but I would like to have permission to submit questions in writing because I think this is a very crucial area, and Treasury has recommended that this is the section that needs to be tightened.

So I would like to have some recommendations. Mr. Seay is the only witness I have heard that gave us recommendations. I would like to have some recommendations if you think that this is an area that could be tightened up a little without hurting your overall purpose.

Thank you.

Mr. FLIPPO. Thank you very much, we will stand in recess.

[Recess.]

Mr. FLIPPO. The subcommittee will resume.

We will ask our guests to please take seats so that we may continue to get the distinguished views of our panel this morning.

We are again, to restate, trying to reexamine current law to see if current law is adequate to deal with the reality that is going on in the marketplace in this area.

One of the things that we are interested in determining and there seems to be general agreement, that there has been a marked increase in the activities of forming taxable subsidiaries or controlled subsidiaries. There seems to have been a marked increase in activity since the Congress adopted the prospective payment system for hospitals and for other competitive and market reasons as well as to new technology.

What we are interested in exploring is, whether or not current law is adequate.

If I understand what you are saying, it is that you think what you are doing is all right under current law. What I am interested in determining is whether or not current law is adequate to deal with the situation. Are unfair activities going on? What changes in current law may be necessary to alleviate the situation?

Would, Mr. Owen, or any panel member care to respond? Let me point out an examples of what I am talking about here.

The Wall Street Journal reported yesterday on page 1 that a growing number of hospitals are selling frozen dinners to people with special dietary restrictions.

Are any of your member nonprofit hospitals engaged in such activities and do they pay the UBIT on their income from the sale of frozen dinners?

There are an enormous number of activities like this. Would any member of the panel care to respond to the general thrust of my point.

Mr. OWEN. Maybe I can start out. There is no question but since prospective payment started in 1982 there is a different attitude from hospitals on where the money is going to come from, and they are looking at related businesses in an approach to solving some of the problems that are out there.

Our feeling is that the law is fairly sound at the present time and it is determined by IRS if it is substantially related or not, if it is not we believe as we have stated that hospitals should pay unrelated business income tax in those areas where it is unrelated.

There is probably some tightening up that could be done. We have made comments in our official statement that you have. But overall most of the present law is being followed rather closely. I just wish that hospitals were making as much money as is implied by the panelists who have been before us. If that were the case, I think we would have a different situation. But I know that is not out there.

Mr. FLIPPO. Dr. DuVal.

Dr. DUVAL. Mr. Flippo, I have no personal knowledge that any of my organizations are engaged in that activity but I don't know that they may not be. I guess I am a little surprised that, in view of the reputation of hospital food, people would be freezing it to sell.

Mr. FLIPPO. Well—yes.

Sister COREIL. Mr. Chairman, I am not aware of any such instances in our own institutions but I would ask the committee to think about it in its broader context. If it is nutrition that is needed, it is maybe needed for diabetics and the hospital has the ability to do it for the people who cannot get out, the elderly, infirm. I would think it is an extension of their primary focus which is to respond to the needs of the community.

We respond to needs of the community, not to make a profit. That is the purpose. To help people. That is why they let us come in. I was amused, I have never been in a hearing before but I am glad to hear about this halo effect. I am glad people know we do good work.

Mr. FLIPPO. Well, on that note, Mr. Schulze, you might jump in here.

Mr. SCHULZE. I thank you, Mr. Chairman.

Sister Coreil, I would like to start off by saying that under your umbrella organization is one in Chester, Pa., Sacred Heart Medical Center which does a marvelous job for a somewhat impacted and impoverished disadvantaged community. You are to be praised for the type of operation that is run there, and we thank you for that.

Sister COREIL. Thank you.

Mr. SCHULZE. I wouldn't take you on anyway.

Mr. Lehrfeld, can you tell me approximately what percentages of your commercial activity receipts go to hospitals and to the temples?

Mr. LEHRFELD. None of the income of the hospital corporation go to the Temples. There are 178 Shrine Temples for the 850 million Shriners in the United States. The income of the hospitals is used exclusively for hospital purposes.

I think your second question was the extent of our unrelated business income?

Mr. SCHULZE. What percentage of your commercial activities, and I would include in that your fundraising activities, some that you referred to in your testimony. Because of time constraints you went rapidly and I didn't get all the figures you were throwing out in your testimony. I am sure that you are aware that your organization has been blasted by the Orlando Sentinel.

Mr. LEHRFELD. You bet.

Mr. SCHULZE. I have a copy of the story where they inferred or stated that the money was going to other places other than hospital activities. I want to give you an opportunity to clear that up and tell me how you divide the money up, where it comes from, and whether it is going to the charitable purposes for which it should be going?

Mr. **Lehrfeld**. We have two entities. We have a 501(c)10 fraternal society with 178 temples for 850,000, I think I said 850 million before—850,000 Shriners. These individuals with the temples engage in a variety of fundraising activities. The Orlando Sentinel articles dealt almost exclusively with temples fund raising practices; one of the 13 articles dealt with the hospitals, I think; so 12 of the 13 dealt with the Shrine fraternal units. There was concern expressed that some of the fundraising activities were fraternal or personal or recreational or social and mislead the public in that income supposedly dedicated for charitable purposes was not.

The hospital corporation has had since 1928 a policy in dealing with the Shrine fraternal units that the hospital's name may not be used for fundraising purposes unless the hospitals are going to take all the profits. In other words, in any Shriner fundraising activity, the circuses, et cetera, the hospitals name cannot be used by the fraternal order unless we receive the net profits. Instances were pointed out by the article, that there was misuse of the hospitals name for recreational and social uses by some Shrine temples.

We didn't dispute that. I would be happy to submit for the record additional information about that. But the amounts of fundraising——

Mr. **Schulze**. One of their complaints was that one-third or less than one-third the money ended up in the hospitals. Were they comparing apples and oranges?

Mr. **Lehrfeld**. They were comparing gross income to net contributions without regard to the actual out of pocket costs to the temple.

Mr. **Schulze**. Tell me how you break it out and how it funnels in if you can.

Mr. **Lehrfeld**. Let's take the Shrine East-West football game sponsored by the temple in San Francisco. You have television revenues, ticket sales, all of that is handled by the Shrine temple. Then the net proceeds, after all the costs have been paid, are dedicated to primarily the San Francisco unit, a 45 bed orthopedic hospital.

Now the amounts collected in gross and the amounts disposed of in net may be 15 or 20 percent, in other words you may have 5 times as much gross as you have profit from that amount.

But as far as the actual accountability goes, there is strict accountability within the fraternal unit and the hospital organization that licensed the fraternal unit to use its name. We would be happy to supply the way that is all run through.

Mr. **Schulze**. I would appreciate having that.

You stated earlier you had money you received through bequests of land and properties and so forth.

Mr. **Lehrfeld**. Yes.

Mr. **Schulze**. Can you tell me how that works? If a bequest is left for the hospital, for a hospital, and I would presume that it would be left to a specific hospital?

Mr. **Lehrfeld**. More often than not, to a specific unit. The Philadelphia unit, for example.

Mr. **Schulze**. Tell me how that would work and how that money would flow through and who would——

Mr. **Lehrfeld**. If you want to deal with an unrelated business, I can give you that example. We received a bequest of a working interest in oil and gas wells located in California.

The decedent's will indicated the property would be held for the benefit of the Los Angeles and San Francisco units. That property becomes the property of a single corporation, Colorado corporation, called Shriners Hospitals for Crippled Children. An allocation is made of the after-tax net income to run the two units. Instead of allocating $50,000 in interest and dividend income to it, we will allocate the net after-tax earnings of the oil and gas working interest so that the budget of the California units absorb what the decedent wanted from his gift of an unrelated business property.

Mr. **Schulze**. Okay. Is it fair to look at your organization's current net worth in relationship to that which goes to the hospitals or is that not a fair way to view the situation?

Mr. **Lehrfeld**. Well, the net worth is, depending on the Dow Jones, an endowment with a value of $2.5 billion.

The total value of the hospital properties is probably another $300 million. We had 135,000 outpatient visits that were free, 16,000 inpatient visits that were free. The total operating budget was $160 million; the research budget, $15 million; construction budget, $25 million. So we are roughly spending about 8 percent of the fair market value of the endowment on hospital services.

Now, I think that is a fair rate of return to the public.

Mr. **Schulze**. In your testimony you indicated that as you go into principal down the road.

Mr. **Lehrfeld**. Correct. We have a hospital in Erie and a hospital in Philadelphia and as I recollect the costs are associated with rehabilitating both of those Pennsylvania hospitals will be in excess of $25 million. That is all going to come from Corpus. Everything is done on a cash basis. There is no borrowing. We use the contributions for all of our capital or rehabilitation costs.

Mr. **Schulze**. You feel the Orlando Sentinel article was a little unfair or they just did not allocate interest and organizations and funds raised to the right places?

Mr. **Lehrfeld**. Nobody is above criticism and certainly nobody is perfect. I know the Shriners don't think of themselves as perfect. But what was unfair is the mischaracterization between the fraternal unit which operates as a fully functioning, fully governed entity, and the hospitals corporation which has its own board of trustees and a board of directors for each hospital. So when you mix the apples and oranges, you are bound to get a misunderstanding as to what uses money is put, and for what purpose.

Mr. **Schulze**. Thank you.

Mr. Leech or Mr. Owen, whoever wants to handle this, I am sure you are aware, a Harvard study suggested that for-profit hospitals offer just as broad a range of services to the medically indigent as do nonprofits. In addition, the study says that the nonprofit status simply subsidizes comfort for physicians. Would you like to comment on either or both of those findings?

Mr. **Owen**. I'll comment quickly on it. We don't think that study was too well done, number one.

No. 2, I think you have to keep in mind that where hospitals are located depends on the amount of indigent care they provide and any time you average out what hospitals provide, you find it skews the picture.

Those hospitals in Pittsburgh or Philadelphia or Chicago or New York or downtown Los Angeles have a bigger indigent load than those that are in the suburbs, so when you average out, the nonprofits do ordinarily provide services within inner cities to a greater degree than you find with the investor-owned. So if you average all suburban hospitals, it is probably close on the amount of indigent care. If you look at just the inner-city hospitals and weigh them against those investor-owned, you would find a lopsided difference. So spreading it over is not a fair study.

I don't think that really demonstrated what some of the nonprofits are doing. You have to keep in mind that in most governments, local or state, there is a responsibility by the government to provide care for indigent poor. This is being taken up by nonprofit institutions in many cases where there are not city or county or state hospitals providing acute hospital care; it is being done by nonprofits.

Mr. SCHULZE. How about the subsidies for the comfort of physicians?

Mr. OWEN. Subsidies for what?

Mr. SCHULZE. Nonprofit status simply subsidizes comfort for physicians.

Mr. OWEN. I am not sure I understand what that means. Subsidizes comfort for physicians?

Mr. SCHULZE. That is what it says. In other words, they are saying they have better working conditions, more accouterments.

Mr. OWEN. I see what you are saying. I don't see that as hardly worth replying to. I think most nonprofit hospitals provide a good working place for physicians. They have an organized medical staff to make sure they are providing quality of care, and peer review organizations. And certainly, from the complaints I have heard from physicians who are complaining about parking and about dressing rooms and other things within the hospital I don't think that too many are that delighted with the accoutrements.

Mr. SCHULZE. Let's get to something that may be more factual. Can you give me the occupancy rate nationwide?

Mr. OWEN. I can give it nationwide. It is about 62 percent right now.

Mr. SCHULZE. Occupancy rate is 62 percent?

Mr. OWEN. Yes.

Mr. SCHULZE. Do you think that tax-exempt dollars and medical subsidies ought to be going to building, enlarging, increasing the beds when there is that large an occupancy rate now, that small a rate?

Mr. OWEN. I think you will find, Mr. Schulze, that that is not happening at the present time. There is very little building taking place today in our hospital business. There is a reduction of beds and there has been during the last 3 years. It has been changed to prospective payment since that time.

Mr. SCHULZE. You don't think funds should be going towards increasing numbers of beds.

Mr. **Owen**. Correct.

Mr. **Schulze**. Okay. I would like to say something. I forget who it was who spoke about the prospective payment. Maybe it was Mr. DuVal. When we put prospective payment into effect, it was based on ratios and costs in existence at that time for hospitals. If they had continued the same way they had been treating patients, it was practically a break-even, maybe a slight profit situation.

From the figures I have seen, most hospitals are making money under the prospective payment system. In my opinion, you are killing the goose that laid the golden egg because what you are doing is shoving the patient out much more rapidly than you had in the past and consequently bringing that stay down and the costs down and we will probably adjust that formula.

So instead of continuing in the process as you had before, in fact it is going to change my idea about hospitals. I think that you have now started shoving patients out as rapidly as possible in order to make a buck. It concerns me and it disturbs me and I don't—if you can send me figures that show that under prospective payment system you are not making money, I would like to have them because the view I have, and some that I have talked to, is it has been a little bonanza for most hospitals.

Mr. **Owen**. I will be happy to provide you figures that show exactly what is happening in the latest update, because what we are hearing and it is true that when it started, hospitals did well in the first year and there was a lot of layoffs and things occurred and there was a profit. But you have already been—I say "you," I mean "it" generically—but Congress has been cutting back that update factor drastically and our statistics show there is only about a 1.2 percent difference between revenue and expense at this time overall and that by 1988 if the update factor is not at least 1.5 percent, we will have 40 percent of the hospitals in this country losing money. We will make that available to you.

Mr. **Schulze**. I would be happy to have them.

[The following was subsequently received:]

DEPARTMENT OF HEALTH & HUMAN SERVICES

[illegible]

The Administrator
Washington, D.C. 20201

June 24, 1987

As you requested, I am sending tables showing projected Medicare hospital margins for FY 1988 assuming various update factors and rates of increase in hospital costs per case. These margins were calculated by subtracting Medicare costs from Medicare payments and dividing by Medicare payments. Both the costs and payments include inpatient passthroughs, as well as costs (payments) subject to PPS.

The analysis was done using a sample of 4757 hospitals for which we have cost data from the second year of the PPS system. The analysis excludes Massachusetts and New York hospitals because we do not have PPS-2 data for them.

As you can see, hospital margins vary dramatically depending on the assumptions about how rapidly hospital costs have increased since PPS-2. It bears emphasis that we do not know which of the assumptions is closest to correct; it depends on how vigorously hospitals respond to the incentives inherent in PPS, and we do not have a reliable model of hospital behavior.

The projected FY 1988 margins assume current law remains in effect with two exceptions: the update factor varies as indicated in the tables and we assumed implementation of the changes proposed in our NPRM published on June 10. The most important features of the NPRM were: a new wage index; case-weighting; recalibration of the DRG weights; changes in the "grouper" system, including dropping age as a basis for separating DRGs; and a change in outlier policy.

Where we were dealing with unaudited PPS-2 cost reports, we made an across-the-board adjustment to costs to simulate the effects of an audit. The adjustment was based on our experience with data from the first year of the PPS system.

These tables incorporate the effect of the transition to national rates, but we have not had time to differentiate the impact of the transition from the impact of the update factor.

Consistent with our usual practice, we have supplied ProPAC and CBO with copies of the data file used for this analysis.

If we can be of further assistance, please let me know.

Sincerely,

Bill

William L. Roper, M.D.
Administrator

Enclosure

-

probably unrealistic

FY1988 SIMULATED PPS MARGINS (PAYMENTS - COSTS / PAYMENTS)
INCLUDING PASSTHROUGHS, EXCLUDING MASS. AND NEW YORK
PPS2 COST PER CASE INFLATED TO FY1988 BY TWO TIMES MARKET BASKET

	NUMBER OF HOSPITALS	FY88 UPDATE 1.5%	.75%	0%
NATIONAL AVERAGE	4757	-7.0	-7.7	-8.4
MEDICARE GROUPS				
URBAN	2341	-6.7	-7.4	-8.1
BED SIZE 0-99	586	-1.9	-2.6	-3.3
100-404	1429	-6.7	-7.4	-8.1
405-684	284	-6.6	-7.3	-8.0
OVER 685	42	-10.2	-10.9	-11.6
RURAL	2416	-8.3	-9.0	-9.7
BED SIZE 0-99	1880	-7.6	-8.3	-9.1
100-169	366	-9.9	-10.6	-11.3
OVER 170	170	-7.8	-8.5	-9.2
TEACHING STATUS				
NON-TEACHING	4023	-7.3	-8.0	-8.7
LIGHT TEACHING (LT .25)	620	-6.9	-7.6	-8.2
HEAVY TEACHING (GT .25)	114	-5.0	-5.6	-6.3
DSH STATUS				
NON DSH HOSPITAL	~~3760~~	-8.2	-9.0	-9.6
DSH URBAN GT 100 BEDS	714	-4.5	-5.1	-5.8
DSH URBAN LT 100 BEDS	77	0.1	-0.5	-1.2
DSH RURAL	206	1.6	0.9	0.2
	997			
SCH/RRC STATUS				
NON SCH/RRC HOSPITAL	4249	-7.0	-7.7	-8.4
SOLE COMMUNITY HOSPITAL	295	-13.0	-13.7	-14.5
RURAL REFERRAL CENTER	179	-4.4	-5.1	-5.8
SCH AND RRC	19	1.8	1.1	0.5
TYPE OF OWNERSHIP				
VOLUNTARY	2816	-7.7	-8.4	-9.1
PROPRIETARY	712	-6.2	-6.9	-7.6
GOVERNMENT	1212	-3.8	-4.5	-5.2
RURAL LT 50 BEDS	1133	-4.9	-5.6	-6.3

FY1988 SIMULATED PPS MARGINS (PAYMENTS - COSTS / PAYMENTS)
INCLUDING PASSTHROUGHS, EXCLUDING MASS. AND NEW YORK
PPS2 COST PER CASE INFLATED TO FY1988 BY ONE HALF MARKET BASKET

	NUMBER OF HOSPITALS	FY88 UPDATE 1.5%	.75%	0%
NATIONAL AVERAGE	4757	9.9	9.3	8.7
MEDICARE GROUPS				
URBAN	2341	10.0	9.4	8.8
BED SIZE 0-99	586	14.6	14.0	13.4
100-404	1429	10.0	9.4	8.8
405-684	284	9.9	9.3	8.7
OVER 685	42	7.5	6.9	6.3
RURAL	2416	9.1	8.5	7.9
BED SIZE 0-99	1880	9.8	9.2	8.6
100-169	366	7.6	7.0	6.4
OVER 170	170	9.6	9.0	8.4
TEACHING STATUS				
NON-TEACHING	4023	9.9	9.2	8.6
LIGHT TEACHING (LT .25)	620	9.8	9.2	8.6
HEAVY TEACHING (GT .25)	114	10.3	9.7	9.1
DSH STATUS				
NON DSH HOSPITAL	3760	8.9	8.3	7.7
DSH URBAN GT 100 BEDS	714	11.7	11.1	10.5
DSH URBAN LT 100 BEDS	77	16.0	15.4	14.8
DSH RURAL	206	18.0	17.4	16.9
SCH/RRC STATUS				
NON SCH/RRC HOSPITAL	4249	9.8	9.2	8.6
SOLE COMMUNITY HOSPITAL	295	5.0	4.4	3.7
RURAL REFERRAL CENTER	179	12.5	11.9	11.3
SCH AND RRC	19	17.4	16.8	16.3
TYPE OF OWNERSHIP				
VOLUNTARY	2816	9.3	8.7	8.1
PROPRIETARY	712	9.9	9.3	8.7
GOVERNMENT	1212	12.9	12.3	11.7
RURAL LT 50 BEDS	1133	12.3	11.7	11.1

FY1988 SIMULATED PPS MARGINS (PAYMENTS - COSTS / PAYMENTS)
INCLUDING PASSTHROUGHS, EXCLUDING MASS. AND NEW YORK
PPS2 COST PER CASE INFLATED TO FY1988 BY ONE HALF MARKET BASKET

	NUMBER OF HOSPITALS	FY88 UPDATE		
		1.5%	.75%	0%
URBAN	2341	10.0	9.4	8.8
NEW ENGLAND	63	12.9	12.3	11.7
MID ATLANTIC	167	10.2	9.7	9.1
SOUTH ATLANTIC	386	10.0	9.4	8.8
EAST NORTH CENTRAL	476	4.8	4.2	3.6
EAST SOUTH CENTRAL	139	11.7	11.1	10.5
WEST NORTH CENTRAL	180	12.8	12.2	11.6
WEST SOUTH CENTRAL	357	10.3	9.7	9.1
MOUNTAIN	92	17.9	17.3	16.8
PACIFIC	481	11.7	11.1	10.5
RURAL	2416	9.1	8.5	7.9
NEW ENGLAND	42	4.6	3.9	3.3
MID ATLANTIC	41	8.8	8.2	7.6
SOUTH ATLANTIC	318	10.8	10.2	9.5
EAST NORTH CENTRAL	352	3.7	3.0	2.4
EAST SOUTH CENTRAL	287	11.5	10.9	10.3
WEST NORTH CENTRAL	561	10.3	9.7	9.0
WEST SOUTH CENTRAL	433	10.8	10.2	9.6
MOUNTAIN	226	9.6	9.0	8.4
PACIFIC	156	9.5	8.9	8.3
ILLINOIS	217	4.1	3.4	2.8
OHIO	184	3.7	3.1	2.4
% OF HOSPITALS NEG. MARGINS		13.9%	25.4%	26.4%

FY1988 SIMULATED PPS MARGINS (PAYMENTS - COSTS / PAYMENTS)
INCLUDING PASSTHROUGHS, EXCLUDING MASS. AND NEW YORK
PPS2 COST PER CASE INFLATED TO FY1988 BY MARKET BASKET

	NUMBER OF HOSPITALS	FY88 UPDATE		
		1.5%	.75%	0%
URBAN	2341	4.6	4.0	3.3
NEW ENGLAND	63	6.9	6.3	5.7
MID ATLANTIC	167	5.4	4.8	4.2
SOUTH ATLANTIC	386	4.4	3.8	3.1
EAST NORTH CENTRAL	476	-0.9	-1.6	-2.2
EAST SOUTH CENTRAL	139	6.6	6.0	5.3
WEST NORTH CENTRAL	180	7.5	6.9	6.3
WEST SOUTH CENTRAL	357	4.9	4.3	3.7
MOUNTAIN	92	13.0	12.4	11.8
PACIFIC	481	6.3	5.6	5.0
RURAL	2416	3.5	2.8	2.2
NEW ENGLAND	42	-1.7	-2.3	-3.1
MID ATLANTIC	41	3.8	3.1	2.5
SOUTH ATLANTIC	318	5.0	4.3	3.7
EAST NORTH CENTRAL	352	-2.3	-3.0	-3.7
EAST SOUTH CENTRAL	287	5.9	5.3	4.6
WEST NORTH CENTRAL	561	4.7	4.1	3.4
WEST SOUTH CENTRAL	433	5.3	4.7	4.0
MOUNTAIN	226	4.1	3.5	2.8
PACIFIC	156	4.0	3.4	2.7
ILLINOIS	217	-1.6	-2.3	-2.9
OHIO	184	-2.2	-2.9	-3.5
% OF HOSPITALS NEG. MARGINS		37.9%	39.4%	40.9%

FY1988 SIMULATED PPS MARGINS (PAYMENTS - COSTS / PAYMENTS)
INCLUDING PASSTHROUGHS, EXCLUDING MASS. AND NEW YORK
PPS2 COST PER CASE INFLATED TO FY1988 BY TWO TIMES MARKET BASKET

	NUMBER OF HOSPITALS	FY88 UPDATE		
		1.5%	.75%	0%
URBAN	2341	-6.7	-7.4	-8.1
NEW ENGLAND	63	-5.7	-6.4	-7.1
MID ATLANTIC	167	-4.6	-5.2	-5.9
SOUTH ATLANTIC	386	-7.3	-8.0	-8.7
EAST NORTH CENTRAL	476	-12.8	-13.5	-14.2
EAST SOUTH CENTRAL	139	-4.1	-4.8	-5.5
WEST NORTH CENTRAL	180	-3.5	-4.2	-4.9
WEST SOUTH CENTRAL	357	-6.2	-6.9	-7.5
MOUNTAIN	92	2.8	2.2	1.5
PACIFIC	481	-5.1	-5.8	-6.5
RURAL	2416	-8.3	-9.0	-9.7
NEW ENGLAND	42	-14.8	-15.6	-16.3
MID ATLANTIC	41	-6.7	-7.4	-8.1
SOUTH ATLANTIC	318	-7.1	-7.8	-8.5
EAST NORTH CENTRAL	352	-14.8	-15.5	-16.3
EAST SOUTH CENTRAL	287	-5.8	-6.4	-7.1
WEST NORTH CENTRAL	561	-6.9	-7.6	-8.3
WEST SOUTH CENTRAL	433	-6.1	-6.8	-7.5
MOUNTAIN	226	-7.4	-8.1	-8.8
PACIFIC	156	-7.4	-8.1	-8.8
ILLINOIS	217	-13.4	-14.1	-14.8
OHIO	184	-14.5	-15.2	15.9
% OF HOSPITALS NEG. MARGINS		64.9%	66.5%	68.1%

FY1988 SIMULATED PPS MARGINS (PAYMENTS - COSTS / PAYMENTS) INCLUDING PASSTHROUGHS, EXCLUDING MASS. AND NEW YORK PPS2 COST PER CASE INFLATED TO FY1988 BY MARKET BASKET

	NUMBER OF HOSPITALS	FY88 UPDATE 1.5%	.75%	0%
NATIONAL AVERAGE	4757	4.4	3.8	3.1
MEDICARE GROUPS				
URBAN	2341	4.6	4.0	3.3
BED SIZE 0-99	586	9.2	8.6	8.0
100-404	1429	4.5	3.9	3.3
405-684	284	4.5	3.9	3.3
OVER 685	42	1.8	1.1	0.5
RURAL	2416	3.5	2.8	2.2
BED SIZE 0-99	1880	4.2	3.5	2.9
100-169	366	1.9	1.3	0.6
OVER 170	170	4.0	3.3	2.7
TEACHING STATUS				
NON-TEACHING	4023	4.3	3.7	3.0
LIGHT TEACHING (LT .25)	620	4.4	3.8	3.1
HEAVY TEACHING (GT .25)	114	5.3	4.7	4.1
DSH STATUS				
NON DSH HOSPITAL	3760	3.4	2.7	2.1
DSH URBAN GT 100 BEDS	714	6.4	5.8	5.2
DSH URBAN LT 100 BEDS	77	10.8	10.3	9.7
DSH RURAL	206	12.7	12.1	11.5
SCH/RRC STATUS				
NON SCH/RRC HOSPITAL	4249	4.3	3.7	3.1
SOLE COMMUNITY HOSPITAL	295	-0.8	-1.5	-2.2
RURAL REFERRAL CENTER	179	7.0	6.4	5.8
SCH AND RRC	19	12.3	11.7	11.2
TYPE OF OWNERSHIP				
VOLUNTARY	2816	3.8	3.2	2.5
PROPRIETARY	712	4.7	4.0	3.4
GOVERNMENT	1212	7.5	6.9	6.3
RURAL LT 50 BEDS	1133	6.7	6.1	5.5

FY1988 SIMULATED PPS MARGINS (PAYMENTS - COSTS / PAYMENTS)

INCLUDING PASSTHROUGHS, EXCLUDING MASS. AND NEW YORK
PPS2 COST PER CASE INFLATED TO FY1988 BY MARKET BASKET

	NUMBER OF HOSPITALS	FY88 UPDATE 1.5%	.75%	0%
NATIONAL AVERAGE	4757	4.4	3.8	3.1
MEDICARE GROUPS				
URBAN	2341	4.6	4.0	3.3
BED SIZE 0-99	586	9.2	8.6	8.0
100-404	1429	4.5	3.9	3.3
405-684	284	4.5	3.9	3.3
OVER 685	42	1.8	1.1	0.5
RURAL	2416	3.5	2.8	2.2
BED SIZE 0-99	1880	4.2	3.5	2.9
100-169	366	1.9	1.3	0.6
OVER 170	170	4.0	3.3	2.7
TEACHING STATUS				
NON-TEACHING	4023	4.3	3.7	3.0
LIGHT TEACHING (LT .25)	620	4.4	3.8	3.1
HEAVY TEACHING (GT .25)	114	5.3	4.7	4.1
DSH STATUS				
NON DSH HOSPITAL	3760	3.4	2.7	2.1
DSH URBAN GT 100 BEDS	714	6.4	5.8	5.2
DSH URBAN LT 100 BEDS	77	10.8	10.3	9.7
DSH RURAL	206	12.7	12.1	11.5
SCH/RRC STATUS				
NON SCH/RRC HOSPITAL	4249	4.3	3.7	3.1
SOLE COMMUNITY HOSPITAL	295	-0.8	-1.5	-2.2
RURAL REFERRAL CENTER	179	7.0	6.4	5.8
SCH AND RRC	19	12.3	11.7	11.2
TYPE OF OWNERSHIP				
VOLUNTARY	2816	3.8	3.2	2.5
PROPRIETARY	712	4.7	4.0	3.4
GOVERNMENT	1212	7.5	6.9	6.3
RURAL LT 50 BEDS	1133	6.7	6.1	5.5

Mr. **Schulze**. I think a lot of you killed the goose that laid the golden egg. But you have no place to look. You have to be introspective. You have to look within yourselves.

I have more questions but I will relinquish. Thank you, Mr. Chairman.

Mr. **Flippo**. Mr. Ford.

Mr. **Ford**. Thank you, Mr. Chairman. I will be brief, but I would like to pose a question to Sister Coreil.

The IRS has held that by operating an emergency room open to all persons and by providing hospital care for all those persons in the community able to pay the cost, the hospital is promoting the health of a class of persons that is broad enough to benefit the community and thus serve the public interest.

The problems that I have been faced with in my area is that we are talking about nonprofit hospitals that are providing services and must maintain emergency room facilities open to the public.

Now, what we have seen is that hospitals have begun to turn away ailing patients but in many instances, in my own home town, the nonprofit hospitals might have emergency room services available to the public, but oftentimes they will dump many of the uninsured patients that walk into or are ambulanced into the emergency room to the city hospital or to the hospital that provides services to all citizens, in most cases, a city hospital paid for by the taxpayers of that county.

Sister **Coreil**. Do you want me to respond to that, Mr. Ford?

Mr. **Ford**. If that is possible, please.

Sister **Coreil**. I can't speak for the field, of course, but I do not believe that any not-for-profit hospital would turn away a true emergency patient or dump them, as you say, because of inability to pay. We have a commitment to people to take care of them and their needs. It may be that a particular hospital—due to their own limited financial resources, because no one has a bottomless pit and we do not get State funds to take care of the indigent—is not able to take every patient. So it may be possible that after stabilizing them or getting them out of their emergency episode, the hospital would suggest that they go to another hospital, or the doctor would suggest it really, because he himself has a monetary interest in it.

But I believe you would be hard-pressed to find—and I would like to see—statistics, because we try to keep a good record of who comes into emergency rooms who may not be admitted and to check on why.

We have people who stay in the emergency room in our own hospitals. We have sisters in the emergency room who monitor what happens and work with the patient's relatives so this does not happen. We are human, so I know sometimes it may, but——

Mr. **Ford**. Indigent care is a problem not only in my area but indigent care and patients all over this Nation are a problem, and I am not suggesting that nonprofit hospitals or private hospitals should assume that responsibility.

Sister **Coreil**. Not all of it.

Mr. **Ford**. Local and State governments must also assume that responsibility and work with private and nonprivate hospitals.

But we find it to be true that in many cases, without naming any hospitals in my area, and I certainly cannot speak for other areas, but serving on a number of subcommittees of the Ways and Means Committee, we have seen these areas on field trips and we hear those stories all over the Nation of many citizens who would not have the ability to pay, would not have the proper coverage of a hospital stay and they oftentimes are in fact turned around at the emergency room level and sent to the city hospital or one of the hospitals that is paid for by the taxpayers of the city of that area or that county.

I am concerned that we see that IRS has indicated that at least the nonprofit hospitals should maintain emergency room facilities but at the same time, when they meet the cash register or the person to admit in the emergency room, when that person is identified, it is identified that he or she does not have the ability to pay, they are turned down and sent to another hospital. That is a problem and you should not be faced with that problem, a nonprofit institution, nor should the private hospitals assume that responsibility. But it is a problem and no one wants to admit that it is a problem.

Sister Coreil. I believe it was a problem, more of a problem a couple, maybe a year or so ago. There was a lot of public notice of dumping. But I would really like to see any kind of statistics that would document that it was a true emergency.

But I agree with you. It is not one person's problem. Government, not-for-profit and for-profit hospitals should help to meet this societal need.

Mr. Ford. Thank you.

Mr. Chairman, I appreciate your recognizing me at this point. I was not here at the opening session today, but the need to review the unrelated business income tax is very important in this area, and I know, to you and other members of this committee, it is an extremely important area. But I am concerned that we move with care in proposing changes to current law.

I, for one, have worked very closely in this area and know that we have a unique tradition of volunteerism and it is a tradition that we know serves us well in this nation, and I would hope we move very cautiously and carefully as we move in the area of UBIT.

Mr. Chairman, I would like to ask unanimous consent to revise and extend my remarks at this time.

Mr. Flippo. Without objection.

[Mr. Ford's statement follows:]

Statement of Congressman Harold Ford

I appreciate the need to review the Unrelated Business Income Tax. But, I am also concerned that we move with care in proposing changes to current law lest we inhibit our unique tradition of voluntarism in this country. It is a tradition that has served us well and contributed enormously to the vitality and well-being of our communities.

Today, we are going to hear about an important segment of the nonprofit sector—human services. Many of us have stated that we do not intend to limit legitimate charitable activities. As we consider this issue, we must be mindful of the potential to inadvertently harm worthwhile, even critical, services and take care not to do so. Voluntarism plays a unique role in our society as it represents our "can do" entreprenuerial spirit as does small business. We need to make sure we preserve this spirit and vitality.

And, today, we will also hear from the cultural community about its mission and the extent to which it utilizes income-producing activities to further its aims. Whether it is an exhibition of art works by contemporary Hispanic artists, the production of grand opera, the development of African American dance, the revival of a classical theater repertoire, the presentation of works by young American composers, or the preservation of biological specimens, the underlying costs are great. For cultural institutions to continue to provide the services that communities have come to expect as a way of enriching their lives, income-producing activity is vital.

Mr. FLIPPO. I might note the gentleman from Tennessee's contributions in this area are widely noted and appreciated.

Mr. FORD. Thank you, Mr. Chairman.

Sister COREIL. If I could take a moment, I would like to respond to something that was said this morning by Mr. Stark and was alluded to by one of our panel speakers.

I know it is in the record, so it concerns me that perhaps someone should at least try to put in the record a response, and it may be better to just give it in writing, but the study Mr. Stark referred to this morning from California, I believe the author indicated that it was not complete information that you could use to evaluate the full contributions of the not-for-profit hospitals. There are many reasons for that. To hear Mr. Stark—I got the impression that everybody agreed with what the conclusion he came to was, and that bothered me.

The restrictions in California data collection are significant. Our own Catholic hospitals indicate that about 30 percent of the care that they give to the poor and the needy is not able to be indicated on those reports; for example, they are not allowed to report services provided in outreach programs and in the homes and the education for the needy.

I think those are services that we need to document. And CHA is doing a study, I think you know that, on our services to the poor so we can better inform you and the public of what we are doing.

But tax exemption is not based only on charity care. There are many reasons why we get that exemption. One is the response we make to society's specialized needs. We provide trauma centers; the for-profits generally do not. They do minimal. We provide neonatal intensive care units; the for-profits generally do not. We do a lot of burn care; the for-profits do minimal.

I think we have to look at it in the total context. I would hope Mr. Stark would review the contributions that the not-for-profits have made to this country and the local communities before he would take the stance he took this morning, which was to cancel our tax exemption.

Mr. FLIPPO. Well, thank you very much for—Mr. DuVal, did you have a final statement?

Mr. DUVAL. Yes, I would like to make one comment. When you returned from your quorum call you posed, I think, a very thoughtful question and one to which we should all address our concerns, and I didn't actually hear it responded to. I am not sure I can. In fact, I am confident I don't have the competence to do so.

But something Mr. Ford said combined with what the Sister has said, suggest that it might be worth recalling that health is a social good. It is not a commodity. When you think about it that way, we can do the best we can to distribute health care as if it were a business; that is, we can do it in a businesslike fashion, but you cannot meet public expectations by distributing care only as a business. It has never been done. No nation in the world has ever done it.

Now, in that context, to the question you posed, tax policy in the United States has always addressed businesses and entities and institutions as they exist as opposed to what they should be.

If you are going to consider modifying the Tax Code, which may be wholly appropriate, I would only remind you if you decide to tax hospitals and health care as businesses, they will react and respond as businesses. And I would submit that that is not in the interest of the public.

Mr. FLIPPO. Well, I appreciate your views. You see what we are primarily interested in is in those areas that are not traditionally traditional services, in both situations and in the commercial activities and magnitude and growing portion of the funds that you use. Concerning commercial activities, we want to make sure that our laws are appropriate for the situation.

I don't think anyone is interested in reducing your ability to deliver the service which you do so well. What we are interested in is the growth in new areas, in real estate, in many other kinds of activities in which we see new evidences of you moving in those areas, and we want to know that you are moving into a level-playing field in carrying out that responsibility.

If you would be kind enough to give us your final views in writing at a later time about the recommendations of the Treasury to this committee, we would find that very helpful. Thank you so much for your patience and your testimony today.

[The following letters were subsequently received:]

American Hospital Association

AHA

Capitol Place, Building #3
50 F Street, N.W.
Suite 1100
Washington, D.C. 20001
Telephone 202.638-1100
Cable Address: Amerhosp

July 22, 1987

Honorable J.J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman

As you requested during your Subcommittee's hearing on the unrelated business income tax, the following are the American Hospital Association's comments on the Department of the Treasury's recommendations on the appropriate tax treatment of tax-exempt organization income producing activities.

One of the key points made by the Treasury Department in its background discussion of income produced by certain activities of exempt organizations bears repeating: there is not sufficient information upon which to base major changes in the law. We do not have a clear picture of the amount of revenue produced, nor the methods used to generate it. AHA agrees that it would serve the interests of the exempt hospitals, the Internal Revenue Service (IRS), the Congress, and the public to work to improve reporting methods. Refinements to the system of defining and computing unrelated business income taxes should not be undertaken until the sources and amounts of revenue are known, and the effects of change may be responsibly estimated.

Policy Considerations

A number of specific points must be made regarding the Treasury Department's discussion of policy considerations in light of the unique nature of the hospital industry. First, Treasury takes a strong, and in our view, appropriate, position that the exemption of public charity activities from taxation is an important part of our economic and social structure. Following this view, however, the Treasury describes the exempt organizations' role as follows:

> "The role of the quasi-governmental, not-for-profit sector should similarly be restricted to that of supplementing, and not supplanting, the activities of for-profit businesses. Thus, tax exemption for public charities should be restricted to those areas where the quality or quantity of goods and services that would be produced strictly through market forces is inadequate."

Although we concur with this policy, we are concerned that a key element is missing. This view is based on the assumption that the government itself is doing its part in providing services directly through its own institutions or through payments to other institutions that provide the services. This is not the case in the health care industry. The AHA's members, 85 percent of which are tax-exempt, provide services to more than 10 million Medicare beneficiaries, at government-set payment rates that often fail to cover costs. Nonetheless, tax-exempt hospitals continue to offer services that government otherwise would be asked to provide.

Approximately 37 million people--mostly poor or near-poor--are uninsured and at significant risk of requiring medical services for which they cannot pay. For these Americans and an additional 20 million "underinsured" Americans, local hospitals--not government--have had to create the medical care safety net. In 1985, uncompensated care cost hospitals $7.4 billion, up from $3.5 billion in 1980. Although local tax appropriations to hospitals were able to cover some of this, $6.3 billion in 1985 medical care costs were truly unsponsored. Tax-exempt hospitals absorbed 75 percent of these costs.

Hospitals have continued to provide this safety net at a time of shrinking resources. The cost of providing hospital care in 1987 is expected to be 13 percent higher than in 1984. However, Medicare prices have increased only 5.6 percent during that same period. New HCFA data demonstrate that even with a 1.5 percent increase in Medicare prices, approximately 40 percent of all hospitals will lose money on Medicare inpatient business in FY 1988. Hence, exempt organizations, and hospitals especially, are absorbing more of the government's responsibilities, and must seek methods to offset the losses, an issue quite apart from reacting to market force pressures.

In the health care field, many of the activities undertaken by hospitals that produce income are carried on for reasons that foster exempt purposes. The public's interests are served when hospitals go outside their role of acute-care providers to operate or cooperate in diversified activities within the health care arena. An integrated and coordinated approach to the delivery of all types of health care services benefits the communities served by tax-exempt hospitals. For example, joint ventures are an important method of creating and maintaining critical ties with alternate delivery and financing entities such as HMOs, PPOs, ambulatory clinics, and home health programs, and ties with physicians or physician groups. Such ventures have important primary purposes other than revenue-raising, for example, to create or solidify relationships with physicians, who are "gatekeepers" to all levels of health care services and thereby to expand the services available to the community.

Accountability is an important factor in determining the continued integrity of tax-exempt status. However, the Treasury Department's concern with this issue is not applicable with respect to the hospital industry. Although privately controlled, not-for-profit hospitals are scrutinized carefully in the delivery of health care services, and disclose considerable information about their operations. Licensing and accreditation authorities review hospital operations, and participation in the Medicare program requires that many conditions regarding operations and services are met. Therefore, in the case of hospitals, many important laws, regulations and other authorities ensure accountability.

Following are AHA's comments on the specific recommendations of the Department of Treasury.

- As stated in our testimony to the Subcommittee, we do not believe that changes to the "substantially related" test are warranted. We agree with Treasury's statement that the test has conceptual merit. In addition, interpretations have allowed considerable flexibility and courts have appropriately looked at the facts and circumstances in the particular case to assess relatedness. AHA believes that there must be efforts to obtain more information concerning activities and revenues before a system based on facts and circumstances is changed. An integrated view of restructured hospitals and related activities is needed in order to obtain useful consolidated information. An expansion of Form 990, including, for example, a line to indicate subsidiary contributions, could provide the integrated view needed.

- The specific deduction should be raised, as suggested by the Treasury Department, to reflect the effect of inflation since 1950. Discussion of a sliding scale reducing the deduction based on UBI amount should follow analysis of data received regarding types of activities and revenue amounts.

- Hospitals set up subsidiaries for many non-tax reasons beyond liability concern and separation from primary exempt activity as mentioned by the Treasury Department. An important reason is the desire to pursue an activity designed to increase contact with patients, physicians and others. Historically, tax-exempt hospitals generally completely control corporate subsidiaries rather than participate with an 80 percent arrangement, and therefore are already beyond the problem Treasury notes.

- The increasing number of hospitals that reorganize or are part of multi-structured systems has raised questions regarding the need to examine the exempt entities' primary purposes. However, the multi-corporate system is still heavily weighted toward hospital operations, i.e., delivery of health care services to patients and, therefore, the accomplishment of the primary charitable purpose. We will be happy to aid in any efforts to consider definitional changes which could serve to address the Treasury Department's concerns.

- Regarding "passive" income, AHA agrees with the Treasury Department's view that the exclusion of such income from unrelated business income provision is appropriate. Potential changes in the definitions of royalty and in the standards regarding research activities should be considered carefully, and AHA will be ready to aid in these efforts.

- The concern about joint venture activities provides further evidence that the information-gathering advocated by the Treasury Department, AHA and others must precede any considerations of change in methods of assessing UBI. As we have stated, joint venture partnerships between exempt hospitals and other entities (many of them also exempt) or individuals are often entered into to perform an exempt function, such as provisions of a health care service previously unavailable in the community. The AHA believes that the interests of hospitals, the public and the IRS would be better served by clear guidance regarding joint ventures in the health care field, and stands ready to help in creating such guidelines.

- AHA agrees with the Treasury Department that the matter of an appropriate sanction for inappropriate activity by a partnership with both exempt and taxable partners is an important one. Some less drastic penalty than loss of exempt status should be constructed, perhaps in the form of a tax or monetary penalty. Again AHA will be pleased to cooperate with any efforts to structure a fair and workable system for sanctions.

As we have stated, the Treasury Department's proposals are a commendable beginning to the complex process of assessing tax policy regarding unrelated business income. AHA believes that it is important to consider the impact on tax-exempt hospitals in light of the unique nature of the health care industry. Most importantly, AHA urges that the information sorely lacking be gathered so that policy may be made in an informed manner, and offers to participate in this process.

I look forward to working with you as you develop your own legislative proposals on the unrelated business income tax.

Sincerely

Jack

Jack W. Owen
Executive Vice President

American Healthcare Institute
Affiliated with American Healthcare Systems

Merlin K. DuVal, M.D.
President

October 27, 1987

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
242 Cannon HOB
Washington, DC 20515

Dear Mr. Pickle:

Our organization, the American Healthcare Institute is a national network of voluntary hospitals - the largest of its kind in the world. It was our privilege to appear before your Subcommittee in June to offer testimony on unrelated business income. Subsequently, we were invited by members of your staff to submit our specific reactions to the seven recommendations made by the Department of Treasury on that topic. We are pleased to have this privilege.

Before responding to these recommendations, however, we feel obligated to point out a serious flaw in the Treasury Department's discussion of policy considerations when it stated that:

> "the role of the quasi-governmental, not-for-profit sector should similarly be restricted to that of supplementing, and not supplanting, the activities of for-profit businesses. Thus, tax-exemption for public charities should be restricted to those areas where the quality or quantity of goods and services that would be produced strictly through market forces is inadequate."

On its face, such a position must be challenged. Churches aside, the bulk of not-for-profit enterprises tend to supplement government rather than the for-profit sector. As has been pointed out by many observers, this is one of the most important distinctions between the United States and the other major nations of the world. To test this hypothesis, one needs only to ask the question "to whom would the responsibility fall for providing the services rendered by most not-for-profit entities if they ceased to exist?" It is not difficult to point out that with respect to hospitals, colleges, universities, welfare and social agencies and perhaps even theaters, museums, etc., it would be the public sector and not the private, for-profit sector to which we would turn to pick up the burden.

1919 Pennsylvania Avenue · Suite 703 · Washington, D.C. 20006 · 202 293-2840

This premise having been stated, we would like to respond to the seven recommendations as follows:

(1) Recommendation Number 1 calls for "more detailed reporting." This is a very general term that could mean anything. Many of society's institutions are, today, heavily burdened with reporting requirements. With respect to hospitals, among the most intensely regulated of all entities, reporting requirements are already sufficiently onerous as substantially to have increased per diem costs for patients and great restraint should be exercised before further increasing that burden.

(2) Recommendation Number 4 calls for broadening the definition of a controlled subsidiary to include subsidiaries in which an exempt organization has more than a 50% interest in stock value or voting power; and, further, that consideration be given to aggregating the activities of an exempt organization and its subsidiaries in appropriate cases. We are fully aware of Treasury's legitimate concerns that in certain cases abuses may occur where a subsidiary controlled by a parent is able to deduct inappropriately high amounts as business expenses payable to the parent. It is our judgment, however, that the recommendation of using a value test, adding ownership attribution rules, and changing the control standard to a 50% test, may be more than is necessary to eliminate the potential for abuse while, at the same time, creating difficulties for many otherwise satisfactory existing arrangements. Further, there is no way to predict, at this time, the circumstances under which the Treasury Department might deem aggregation to be appropriate. By implication, aggregation would occur only in situations where a disproportionate part of the total business activity was unrelated to the parent's charitable purposes. Nevertheless, where subsidiaries are separately incorporated and managed, and their affairs are being conducted in the same manner as other businesses of comparable types, aggregation may result in consequences to the parent that could have unwarranted effects upon the parent.

(3) With respect to recommendation number 5, we have no objection to the intent of the recommendation but it is critical that there be no misunderstanding of how important it is to maintain the ability of not-for-profit organizations to continue to be permitted to use investment income to support the purposes for which they achieved tax-exempt status in the first instance.

(4) Recommendation Number 7 suggests that current restrictions on partnership allocations between taxable and tax-exempt partners may not be adequate to prevent abuse. We believe that all reasonable steps should be taken to prevent abuse but, at the same time, we are concerned about such changes as might be made affecting joint venture activities, especially those that may involve partnerships between tax-exempt organizations and others. We are sensitive to the private benefit issues that can arise in such a structure and are conscious of the close scrutiny to which any such venture will be subjected. However, we believe such ventures should not be discouraged out of hand, particularly where they support legitimate charitable purposes. At present, rules and guidelines are adequate to prevent abuse. We also agree, however, that the remedy for violation of any rule should be, as Treasury recommends, the imposition of tax rather than the loss of exempt status.

Some of the seven Department of Treasury recommendations were not addressed in this letter. The primary reason is that those not commented on appear to be fair, reasonable and would be supported by our organization.

Your attention and interest are appreciated.

Very sincerely yours,

Merlin K. DuVal

United
Hospital Fund

Shaping New York's Health Care:
Information, Philanthropy, Policy

55 Fifth Avenue
New York, NY 10003-4392
212 645-2500

Honorary Chairmen of the Board
Donald M. Elliman
Douglas T. Yates

Officers
De Witt Peterkin, Jr
Chairman of the Board

Bruce C. Vladeck
President

Mrs. Thomas J. Fleming
Frederick D. Forsch
Mrs. Edward H. Gerry
E. Everett Smith
Vice Chairmen

William L. Cobb, Jr
Treasurer

J. David Seay
Vice President and
Secretary

David A. Gould
Sally J. Rogers
Eileen M. Scott
Vice Presidents

Directors
Alan R. Batkin
Herbert C. Bernard
Mrs. Hiram D. Black
Mrs. Charles N. Breed, Jr
John K. Castle
J. Barclay Collins, II
Robert Curvin
William M. Evarts, Jr
Alfred Finkel
Mrs. Thomas J. Fleming
Frederick D. Forsch
Mrs. Edward H. Gerry
Mrs. Herbert Greenberg
Kevin Keogh
L. Patton Kline
Wilson Nolen
James E. Osborn, II
De Witt Peterkin, Jr
Mrs. Lewis Schachne
E. Everett Smith
Howard Smith
Bruce C. Vladeck
Albert L. Zesiger

Honorary Directors
Mrs. George M. Billings
Mrs. H. Lawrence Bogert
Joseph C. Brennan
Carlton M. Fishel
Gordon C. Griswold
Henry B. Guthrie
William A. Lydgate
William S. Renchard
Herbert M. Singer

July 14, 1987

COMMITTEE ON
JUL 15 1987

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
1102 Longworth Building
Washington, D.C. 20515

Dear Mr. Leonard:

When I appeared before the Oversight Subcommittee of the House Ways and Means Committee on June 26th, 1987 to testify as to the views of the United Hospital Fund of New York regarding the Unrelated Business Income Tax of charitable organizations, the Subcommittee requested that each member of the panel of which I was a member submit written comments on the position of the Treasury Department on this topic. Therefore, the comments that follow refer to the "Statement of O. Donaldson Chapoton, Deputy Assistant Secretary (tax policy), Department of the Treasury, before the Subcommittee on Oversight of the Committee of Ways and Means, United States House of Representatives, June 22nd, 1987." The first paragraph of my comments will be general in nature, and the subsequent numbered paragraphs respond to the numbered issues and recommendations listed in Mr. Chapoton's testimony on pages 3 and 4.

Generally speaking, we are in agreement with the position taken by the Department with regard to the overall conceptual soundness and validity of the Unrelated Business Income Tax law, and feel, like the Department, that no radical changes are called for at this time. The contributions of the not-for-profit and charitable sector of our country, in concert with the work of the public sector, have been the backbone of our society's efforts to address our most serious social ills, such as illiteracy, illness, inadequate food and shelter, and the like, and also have allowed us to achieve some of our greatest successes, including cures for diseases, and the cultural enrichment of music, theatre, dance, and the arts. We would urge extreme caution in consideration of tax policy changes that could adversely affect the delicate balance of the environment within which these often precariously-funded organizations exist and operate. At the same time, however, all of us should be mindful of any real abuses that occur and should strive, together, to spread the net of enforcement wide enough to catch those abuses. But at the same time we must not be overreaching in those efforts. In summary then, we feel that the basic

Unrelated Business Income Tax law is sound and that any changes that could be made, as I mentioned in my testimony of June 26th, 1987 before the Subcommittee, should involve more information, better enforcement, improved disclosure, and a continuation of cooperation between the government and our sector.

1. With respect to the "substantially related" standard, we agree with the Department that no changes in the standard are called for at this time. However, in an effort to clarify the standard and to strive for more uniform application of it, we agree that better reporting can be a means of improving enforcement and compliance. It should be pointed out, however, that application of the standard, by necessity, will vary to some extent by the type of organization and endeavor involved. For example, hospitals have long been urged by public officials and public policy experts alike to become more involved in "vertically integrated" health care services to provide a continuum of care and better continuity of care for their patients and communities. Following this suggestion, many hospitals have become involved in outpatient clinics, outreach services, retail drug and equipment distribution, home care services, and the like, all in an effort to meet their mission of providing the best quality medical care to their patients. As medical care has changed in the past several decades, it is important that the vehicles of public policy recognize these changes and not, for example, adhere to more narrow and now outmoded traditional definitions of "hospital care." An overly restrictive and narrow construction of the "relatedness standard" could run the risk of inhibiting innovation to improve health services by the voluntary hospital sector, which has and continues to represent the vast majority of hospital beds in this country. (I will note in passing that the rather short-lived fascination with the hospital sector by for-profit companies appears to have begun to run its course, with most of the large chains divesting themselves rapidly of hospitals and hospital beds. Whether this represents the fact that the owners of such enterprises have recognized the essential non-profitability or fundamental non-market-oriented nature of hospital care delivery, is open for conjecture. However, the result will probably be that government and voluntary institutions will continue to account for well in excess of ninety percent of all hospital beds in the United States.)

2. Concerning exceptions from the "substantially related" standard, we agree with the Department that the provision exempting sales of donated property is appropriate. Also, we are as concerned as the Department about any possible abuses of the exemptions for businesses operated by volunteers or "for the convenience of students, patients, and others." However, as this provision relates to patients of hospitals, whether they are inpatients or outpatients of the institution, we are unfamiliar with any instances where the activities would not otherwise be included in the "substantially related" standard. Once again, we agree with the Treasury Department that more information is needed so that policy can be based upon sound data rather than upon anecdote.

3. Regarding the computation of the tax on unrelated business income, we applaud the Treasury Department's acknowledgement of some confusion in the rules for allocation of expenses. Clearly, where confusion exists, both the government and our sector will benefit by clarification of the appropriate relationship between an organization's exempt functions and unrelated activities. Furthermore, we also feel that the "fragmentation rule" need not be changed at this time, and that the increase in the specific deduction from unrelated business income to $5,000, while still extremely low, is at least a step in the right direction.

4. With respect to the Treasury's recommendation that the definition of a "controlled subsidiary" be broadened to include subsidiaries in which an exempt organization holds in excess of 50% of the stock value or voting power, here too, we feel that a lack of information may be at the root of perceived problems or uncertainties. We would urge caution in moving in this direction, and certainly would specifically recommend that a careful study be conducted by the Internal Revenue Service, in cooperation with our sector, to evaluate the impact of such proposed changes on hospitals and related health care institutions. We are definitely not in favor of protecting any abuses that may be occurring, but we do not support changes that might at the same time disrupt the delicate balance among these highly complex corporate arrangements of "non-offending" organizations.

5. We agree wholeheartedly with the Department's recommendation that the passive investment income of public charities continue to be exempt from taxation. This is, and has been, an extremely important area for public charities, especially in the health care field, and we feel very strongly that any attempt to tax this source of revenue would seriously affect the ability of such organizations to provide community service. As the Treasury Department's analysis of this subject implies, it may well be illogical to tax this income of charitable organizations that would otherwise be spent for the type of activities that would be within the domain of the government to provide. With regard to the suggestion that the exclusion for royalties be narrowed, we would only suggest that more careful study of the issue be undertaken in an effort to limit the impact of the restricted definition to only those organizations that may be actually abusing the provision. The analysis provided by the Department in its testimony in this regard provides insufficient data and information upon which to base a substantive change.

6. With regard to the exclusions from taxation of income derived by charitable organizations for research activities, we disagree with the Department that the definition is overly broad, at least with respect to the types of research conducted by ourselves and our member hospitals with which we are familiar. We feel very strongly that research, especially as long as the findings and implications are

broadly disseminated, should be encouraged within our society, and that one way to do that is to refrain from taxing charitable organizations that undertake such research activities. We are not aware of abuses in the hospital sector in this regard, and in fact feel that the definitions provided in current regulations, as specifically enumerated on page 35 of the Department's testimony, paragraph 1, are indeed, if anything, too narrow. For example, we feel that it is legitimate that research into the effects and impact of changes in health care reimbursement mechanisms is legitimate research which should be included in this exemption. However, it is not clear that research of this nature is included. In addition, the very nature of research, as an intellectual exercise designed to explore and pursue various avenues of investigation and analysis, may well require a less restrictive definition if the social goal is to encourage its pursuit.

7. Perhaps the most complex and complicated area that was addressed by the Department's testimony is the area of joint venture activities of exempt organizations. We agree with the Department that the detailed and highly sophisticated nature of these organizational arrangements may increase the risk of abuse, not only with regard to the allocations within the partnership between taxable and tax exempt partners, but also regarding the issue of private inurement. In summary, if the Department's position can be interpreted as calling for more and better information, as well as careful study, in this area, once again we are in agreement with their position.

In conclusion, I would like to make two points. First, we feel that the importance of attempting to address this nation's social and health care issues is much too important to be left up to just the government, and that the historical reliance upon the not-for-profit and charitable sector as well as government in pursuit of these goals is good, and deserving of continued public policy approbation, not only through the vehicle of the tax law and tax policy, but through other mechanisms as well. In this regard, we would urge that any proposed changes be analyzed with this long-standing position in mind. Second, I would like once again to thank you for the opportunity to make our views known not only through our testimony on June 26th, but also in this letter.

If you have any questions or desire additional information, please do not hesitate to contact us.

Sincerely yours,

J. David Seay

cc: Bruce C. Vladeck
Joseph M. Rees

Mr. Flippo. We move now, and have asked some academicians to join us and share their views, if they would come to the table. We have Gabriel Rudney, senior research associate, Institution for Social and Policy Studies, Program on Nonprofit Organizations, Yale University, and also on the panel is Bradford Gray, who is the study director for the Institute of Medicine at the National Academy of Sciences.

I might also invite to the witness table at this time, although it will be a little different subject matter, Mr. Jack Pfister, the chairman of the Arizona Board of Regents of the Association of Governing Boards of University and Colleges. He will be our next witness.

Mr. Rudney, if you would please give us your testimony and understand our difficult time constraints.

STATEMENT OF GABRIEL RUDNEY, SENIOR RESEARCH ASSOCIATE, INSTITUTION FOR SOCIAL AND POLICY STUDIES, PROGRAM ON NON-PROFIT ORGANIZATIONS, YALE UNIVERSITY

Mr. Rudney. Mr. Chairman, thank you. My name is Gabriel Rudney. I am pleased to have this opportunity to discuss my views regarding the Federal income tax treatment of income-producing activities of organizations that have tax-exempt status under section 501 of the Internal Revenue Code.

Although my views are directed at nonprofit hospitals they are relevant to income-producing activities of other public benefit organizations; that is, those in sections 501(c)(3) and 501(c)(4).

I have submitted a complete statement for the record. I am an economist. I am a senior research associate in the program on nonprofit organizations at Yale's Institution for Social and Policy Studies. My principal research interest has been public policy related to nonprofit organizations and private philanthropy. I appear in my own capacity. I represent no organization.

Mr. Chairman, I support and advocate a public policy directed at sustaining a strong nonprofit sector. I admire and appreciate the well-known philanthropic spirit of Americans who donate moneys, property, and countless hours of volunteerism. I understand and appreciate the selfless devotion of nonprofit managers who implement philanthropic goals.

While I am concerned about competitive advantage of nonprofits, a subject on which I have written, I am equally concerned about commercialism in the nonprofit sector. The overview and insight I have gained in this field in my work has permitted me to observe that the accelerated expansion of commercialism threatens and endangers the future of the nonprofit sector as we have known it.

Accelerated expansion of commercialism which began as a means to supplement contributed funds to carry out nonprofit operations is threatening to convert the fundamental donative basis and rationale for public benefit nonprofits into essentially a commercial one. The General Accounting Office report earlier this year provided 1984 data.

Overall, among public benefit nonprofits, donations accounted for 28 cents for every dollar of revenue, but donations ranged from as little as 9 cents of the revenue dollar in health services to 96 cents on the dollar in religious organizations. Further, while the expansion of commercialism in certain instances is creating and exacerbating competitive problems in related income-producing activities, it has also obscured the fundamental purposes of nonprofits and caused many organizations to lose sight of their exempt mission.

I see on the horizon a clear and future threat to charitable giving, the fundraising process, and the accomplishment of charitable missions. Both the commerciality and competitive issues need to be resolved.

Mr. Chairman, Mr. Pickle, in his remarks earlier this year at the Washington nonprofit tax conference stated, "We, the subcommittee, are going to determine whether current rules set forth proper standards for determining whether income-producing activities for tax-exempt organizations are being properly taxed."

I want to respond to that. The current rules generally do not provide the proper standards for income-producing activities. I propose for the subcommittee's consideration alternative rules for determining whether income-producing activities should be taxed. I propose that the subcommittee consider extending the rules of section 501(m).

The Congress established section 501(m) last year when it enacted the Tax Reform Act of 1986. The section denies tax exemption to public benefit nonprofits if they provide commercial-type insurance that is a substantial part of the activities of the nonprofits. Even if the nonprofit obtains tax-exempt status, the section taxes all commercial-type insurance activities of an exempt organization in the same way the code taxes taxable insurance companies.

The section, however, exempts insurance provided at substantially below cost to a class of charitable recipients. The exempt insurance activity is defined as not commercial-type insurance. In establishing section 501(m), the Congress had found that the application of the relatedness test since 1950 had not resolved adequately the competitive advantage issue in the sale of commercial-type insurance by nonprofits.

Moreover, the application for the relatedness test encouraged the growth of commercial-type insurance considered related to the exempt purpose of the nonprofits. On enacting section 501(m) the Congress viewed the insurance activity of public benefit nonprofits as an activity whose nature and scope is inherently commercial rather than charitable.

Further, the Congress adopted the rule that the sale of insurance at a price sufficient to cover costs generally constitutes an activity that is commercial. The Congress distinguished between insurance activity of a charitable nature and insurance activity of a commercial nature.

Although for-profit insurance sold in the marketplace has social and community value because it satisfies the needs of purchasers, it is not granted a tax exemption. Consistent with this, Congress enunciated a policy that commercial-type insurance sold by nonprofits has no special social or community value which warranted tax exemption, but that charitable insurance did.

The enactment recognized that the marketplace will adequately supply insurance to meet the demand. In effect, the establishment of section 501(m) represents in my view congressional initiation of a principle of what I call "private marketization without tax subsidy" of commercial-type activity by nonprofits.

This principle recognizes that the public has the opportunity to exercise choice among commercial products or services offered by nonprofit business and for-profit business without government intervention by tax subsidy. On the supply side, the nonprofit as well as the for-profit enterprise compete choosing to offer the quantity and quality of a product or service at a price without Government intervention by tax subsidy.

Is there a similar commerciality issue in the nonprofits hospital area? There is, Mr. Chairman, but first a little background. The only test for exemption of a nonprofit hospital is as a charitable organization. Originally, the IRS position on exemption of hospitals was that they meet a financial ability test. The hospital had to provide health care to those who could not afford to pay to the extent of the hospital's financial ability.

If a hospital operated exclusively for those who could pay, it risked loss of its exemption. These were the requirements in support of the term, "charitable." However, the IRS changed its position in 1969 and substituted a "community-benefit" test for the "financial ability" test. The Service took the view that a hospital is charitable if it promotes health generally.

Under the rule, a tax-exempt hospital was free to restrict the provision of health care to paying patients. Until 1969, the Service insisted that an exempt hospital must offer a significant amount of free care to the indigent and needy. The Service abandoned that rule and thereby abandoned the traditional view that an exempt hospital was a charity providing for the needy.

The 1969 rule has been challenged in the courts and the Service's position was upheld by a Supreme Court decision in 1976 in the *Eastern Kentucky Welfare Rights Organization* case. However, the recent 1986 congressional action in establishing section 501(m) in effect overruled the community-benefit principle in order to distinguish commercial and charitable insurance provided by exempt public-benefit organizations.

In addition, the public-benefit principle was challenged in a 1985 Utah Intermountain Health Care judicial decision. The issue there was whether a nonprofit hospital was charitable or commercial. The court used factual considerations to determine whether or not a nonprofit hospital was charitable in nature. In its decision, the overriding principle enunciated by the Court was that the essence of charity is an act of giving, and that to be charitable the hospitals had to demonstrate the principle of gift to the community.

The Court emphasized the difference between gift to the community, a necessary element of charity, and community benefit, which many profit seeking hospitals, as well as nonprofit hospitals provide.

Mr. Chairman, nonprofit hospitals are essentially commercial. They are heavily involved in the marketplace in competition among themselves and with for-profit hospitals.

This commercialism creates repercussions in the more clearly charitable areas of hospital activity. Just as the Congress found in its establishment of section 501(m) last year, that the competitive growth of private health insurance caused nonprofit health insurance providers to give up the coverage of high-risk individuals, the competition of profit-seeking hospitals and the fixed fee requirements under Medicare and Medicaid have eroded the ability and often the desire of nonprofit hospitals to continue unprofitable charitable activities.

Mr. **Flippo**. Mr. Rudney, I apologize for interrupting. We are anticipating a vote almost at any moment. Your testimony is helpful, but if you could summarize.

Mr. **Rudney**. I will go to my conclusion.

To conclude, Mr. Chairman, my proposal to extend section 501(m) to deny tax exemption to commercial-type activity of nonprofit hospitals would be a major legislative change, but it would only be a partial response in my judgment to your broad query whether income-producing activities are being properly taxed.

In that respect, and in the interest of consistency and equity, the subcommittee should consider extending section 501(m) treatment to commercial-type activity of all public-benefit nonprofits under sections 501(c)3 and 501(c)4. It would limit the scope of tax-exempt activities by making commercial-type activities taxable.

It would encourage more dependence on donations and fundraising process to support the exempt mission. This is a wide-ranging proposal, Mr. Chairman, to distinguish commercial from charitable and other activities that have a special social value.

Clearly because of its scope, the proposal requires extensive study, keeping in mind the social value of nonprofits as well as the need to limit commerciality and resolve competitive problems. Thank you.

[The statement of Mr. Rudney follows:]

STATEMENT OF R
GABRIEL RUDNEY
SENIOR RESEARCH ASSOCIATE, YALE UNIVERSITY'S
INSTITUTION FOR SOCIAL AND POLICY STUDIES
(PROGRAM ON NON-PROFIT ORGANIZATIONS)
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
JUNE 26, 1987

****

Mr. Chairman and Members of the Subcommittee:

My name is Gabriel Rudney. I am pleased to have this opportunity to discuss my views regarding the Federal income tax trestment of income-producing activities of organizations that have tax-exempt status under section 501 of the Internal Revenue Code. Although my views are directed at nonprofit hospitals, they are relevant to income-producing activities of other "public-benefit" organizations (sections 501(c)(3) and 501(c)(4).

I am an economist. In 1982, I completed a long public service career at the U.S. Treasury, where I participated in the development of many tax policy initiatives. I served in the mid Seventies, while on leave from the Treasury, as research director of the privately-established Commission on Private Philanthropy and Public Needs, chaired by John Filer of Aetna. My responsibilities at the Commission provided me with a complete and thorough overview of private philanthropy and public-benefit organizations.

Since 1982, I have been Senior Research Associate in the Program on Non-Profit Organizations at Yale's Institution for Social and Policy Studies. My principal research interest has been public policy related to nonprofit organizations and private philanthropy. Our research has had the financial support of private foundations and corporate business.

I have consulted with or advised nonprofit and business organizations, as well as the Treasury and Internal Revenue Service. I testify today in my own capacity based on my many years of experience in this domain. I represent no organization.

Mr. Chairman, I support and have always advocated a public policy directed at sustaining a strong nonprofit sector. In my work as Research Director of the Filer Commission, we sought to put the nonprofit sector on the economic map, where its invaluable contributions to society and to our economy had never before been clearly demonstrated. I admire and appreciate the well-known philanthropic spirit of Americans who donate moneys, property, and countless hours of voluntarism. I understand and appreciate the selfless devotion of nonprofit managers who implement philanthropic goals.

While I am in accord with and sympathetic with the objectives of the philanthropic process and nonprofit operations, the overview and insight I have gained in this field, has permitted me to observe that certain developments are occuring which threaten and endanger the future of this nonprofit sector as we have known it. The major development has been the accelerated expansion of commercialism in the nonprofit sector, which began as a means of supplementing contributed funds to carry out nonprofit operations. The commercial activities of certain nonprofits are threatening to convert the fundamental donative basis and rationale for public-benefit nonprofits into essentially a commercial one. The Government Accounting Office report earlier this year provided 1984 data. Overall among public-benefit nonprofits, donations accounted for 28 cents for every dollar of revenue. But donations ranged from as little as 9 cents of the revenue dollar in health services to 86 cents on the dollar in religious organizations. In addition, the expansion of commercialism in certain instances is creating and exacerbating competitive problems in related and unrelated income-producing lactivities, and obscuring the fundamental purposes of nonprofits. In related activities, the expansion of commercialism and and the adoption of commercial practices and objectives, has, in many cases inadvertently, caused many organizations to lose sight of their exempt missions. I see on the horizon a clear and future threat to charitable giving, the fundraising process, and the accomplishment of charitable missions. We need to attempt to resolve the commerciality and competitive issues before they get out of hand.

However, the basic justification for tax exemption and the sometimes supportive and sometimes conflicting policies that have evolved since 1950 from legislation and from administrative and judicial interpretations, make solutions to the issues of commercialism and competitive advantage difficult and controversial. Thus, often a change in policy is a choice between approaches that appear to have conflicting objectives. Thersfore, in attempting to resolve the issues, we need to be aware that the the social value of nonprofits often comes into conflict with the policy of limitations on tax-exempt status or with the policy of equitable resolution of competitive problems. In this repect, the proposal I offer, if considered, needs adequate study from all of these perspectives.

The Proposal

Mr. Chairman, in your remarks earlier this year at the Washington Nonprofit Tax Conference, you stated: "We [the Subcommittee] are going to determine whether current rules set forth proper standards for determining whether income-producing activities [of tax-exempt organizations] are being appropriately taxed."

I want to respond to that. The current rules generally do not provide the appropriate standards for income-producing activities. I propose, for the Subcomittee's consideration, alternative rules for determining whether income-producing activities should be taxed.

My focus is on nonprofit hospitals, but the proposed rules are equally applicable to other types of public-benefit nonprofits (sections 501(c)(3) and 501(c)(4)). Consideration should be given to extending the basic policy of section 501(m) to all commercial-type activities of public-benefit nonprofits. The Congress established section 501(m) last year when it enacted the Tax Reform Act of 1986. The section denies tax exemption to public-benefit nonprofits if they provide commercial-type insurance which is a substantial part of the activities of the nonprofit. Further, the section taxes all commercial-type insurance activities of an exempt nonprofit in the same way the Code taxes taxable insurance companies. The section, however, exempts insurance provided at substantially below cost to a class of charitable recipients. The exempt insurance activity is defined as not "commercial-type insurance".

My proposal is to amend section 501(m) to cover all "commercial-type activitiy". It would limit the scope of tax-exempt activities by making commercial-type activities taxable. It would encourage more dependence on donations and the fundraising process to support the exempt mission. Clearly, because of the scope of the proposal, it requires extensive study.

Reasons for Proposal

In establishing section 501(m), the Congress had found that the application of the "relatedness" test since 1950 had not resolved adequately the competitive advantage issue in the sale of commercial-type insurance by nonprofits. Moreover, the application of the "relatedness" test encouraged the growth of commercial-type insurance considered related to the exempt purposes of nonprofits. In enacting section 501(m), the Congress ignored in part the "relatedness" test and viewed the insurance activity of public-benefit nonprofits as an activity whose nature and scope is inherently commercial rather than charitable. Further, the Congress adopted the rule that the sale of insurance at a price sufficient to cover costs generally constitutes an activity that is commercial. The Congress distinguished between insurance activity of a charitable nature and insurance activity of a commercial nature. Although for-profit insurance sold in the marketplace has social and community value because it satisfies the needs of purchasers, it is not granted a tax exemption. Consistent with this, Congress enunciated a policy that commercial-type insurance sold by public-benefit nonprofits has no special social or community value which warranted tax exemption, but that charitable insurance did. The enactment recognized that the marketplace will adequately supply insurance to meet the demand. In effect, the enactment of section 501(m) represents in my view the initiation of "private marketization without tax subsidy" of commercial-type insurance by non-profits. The public has the opportunity to exercise choice among the insurance products being offered by nonprofit and for-profit insurance companies without indirect government intervention of a tax subsidy. On the supply side, the nonprofit and for-profit insurance enterprises compete by providing the quantity and quality of insurance at a price.

Is there a similar commerciality issue in the nonprofit hospital area? There is, Mr. Chairman. But first, a little background, based on a recent NYU tax law article by a prominant legal authority on exempt organizations, Jerry McCoy. The only available basis for exemption of a nonprofit hospital is as a "charitable" organization. Originally, the Internal Revenue Service's position on exemption of hospitals was that they meet a "financial ability" test. A hospital had to provide health care to those who could not afford to pay, to the extent of the hospital's financial ability. If a hospital operated exclusively for those who could pay, it risked loss of its exemption. Such were the requirements in support of the term "charitable".

However, the Service changed its position in 1969 and substituted a "community benefit" test for the "financial ability" test. The Service took the view that a hospital is "charitable" if it promotes health generally. Under the rule, a tax-exempt hospital was free to restrict the provision of health care to paying patients. According to McCoy, until 1969, the Service insisted that an exempt hospital must offer a significant amount of free care to the indigent and needy. The Service abandoned that rule and thereby abandoned the traditional view that an exempt hospital was a charity providing for the needy. The 1969 rule has been challenged in the courts and the Service's position was upheld by a Supreme Court decision in 1976 in the Eastern Kentucky Welfare Rights Organization case.

However, the recent 1986 Congressional action in establishing section 501(m), in effect overruled the "community benefit" principle in order to distinguish commercial and charitable insurance provided by exempt public-benefit organizations. In addition, the "community benefit" rule was indirectly challenged and overruled in the 1985 Utah County-Intermountain Health Care decision. The issue there was whether a nonprofit hospital was "charitable" or "commercial". The court found the assumption that a nonprofit hospital is "charitable" has little relationship to the economics or business of the hospital industry. The court used five factual considerations to determine whether a nonprofit hospital was charitable in nature. According to McCoy's analysis, the considerations were:

"1. Whether the governing instrument of the hospital identifies as its purposes, activities consistent with a charitable use, and precludes inappropriate inurement of private benefit.

2. Whether and to what extent the hospital is supported by donations and gifts. This is a particularly important indicator; if current operating costs are covered primarily by revenue from patient charges, this fact suggests the absence of a charitable operation.

3. Whether the recipients of the hospitals' services are required to pay, in whole or in part, for that assistance. The Intermountain Hospitals had failed to demonstrate any substantial imbalance between the value of the services provided and the payments received therefor. Most of the services provided by these hospitals were paid for by government programs, private insurance companies, or the patients themselves. [According to the court] collection of such remuneration does not constitute giving, but is a mere reciprocal exchange of services for money.

4. Whether the hospital's income from all sources exceeds its operating and maintenance expenses. The court concluded that the existence of an operating profit, even if used for capital improvements and new, updated equipment, militates against charitable status. The court noted here the purportedly nonprofit organizations often function in a manner no different from that of profit-seeking entities.

5. Whether the beneficiaries of the services of the hospital are 'restricted' in any way and whether private interests are benefited by the organization or operation of the hospitals. An underlying issue here is whether the institutions in question viewed themselves as being in business of providing hospital care for the poor, in accordance with the original rationale for hospital exemptions. Intermountain's ownership of a for-profit entity, as well as the conduct of private commercial enterprises (such as pharmacies, laboratories and medical service contracts) were viewed as departures from purely charitable motivation."

According to McCoy, the overiding principle enunciated by the court was that the essence of charity is an act of giving, and that to be charitable the hospitals had to demonstrate the principle of "gift to the community" The court emphasized the difference between "gift to the community", a necessary element of charity, and "community benefit", which many profitable businesses provide.

Mr. Chairman, nonprofit hospitals are essentially commercial. They are heavily involved in the marketplace in competition among themselves and with for-profit hospitals. This commercialism creates repercussions in the more clearly charitable areas of hospital activity. I am not a health care expert. To describe briefly how commercialism has affected the mission of nonprofit health care, I am dependent on the work of health care experts: Yale's Theodore Marmor and Richard Smithey and Harvard's Mark Schlesinger. [The three prepared an excellent chapter on nonprofits and health care for The Research Handbook on the Nonprofit Sector published this year by the Yale Press. My comments are based on that chapter.]

First, The competitive growth of private health insurance coverage, caused the nonprofit health insurance industry, largely Blue Cross-Blue Shield, to give up its implicit subsidy of high risk individuals. They mirrored the for-profits who avoided such high risks. Blue Cross-Blue Shield, reacting in the commercial spirit, was more worried about the competition and its market share than its mission for which it was granted tax exemption. Third party financing, particularly under Medicare and Medicaid, transformed medicine and health care into a virtual gold mine for commercial nonprofits as well as for-profits.

Second, in the not so distant past, runaway health care inflation brought about increased price competition among nonprofit and for-profit hospitals. More recently, the fixed price schedules imposed on hospitals has changed the market struggle to competition by advertising and by cost controls and other efficiencies such as cut-backs in health services. This competitive commercialism has eroded the ability of nonprofit hospitals to cross-subsidize particular types of care and patients. According to the experts, the diminished cross-subsidization of patients and services has reduced the ability of nonprofit institutions to offer unprofitable services, which previously distinguished them from their for-profit counterparts. As a consequence, the loss of cross-subsidization and the increased dumping of the sickest and the poorest from private nonprofit facilities, has threstened the financial stability of many public hospitals.

Third, the trust and popular expectations that the public has long had in health care providers--hospitals and doctors--has eroded as a more commercially-oriented ethic apparently replaced the service ethic among such providers.

Fourth, the growth of commercialism in nonprofit hospitals in the face of competition is in great part a reflection of the employment growth of management and financial professionals whose role is strengthened by commercial goals and crisis. The result is that the nonprofits increasingly mirror profit-seeking competitors. They restructure organizationally. They establish holding companies. They establish for-profit subsidiaries. They put together multifacility chains. One can safely say that the competitive practices of nonprofits and for-profits have converged.

Mr. Chairman. I question the appropriateness of the "community benefit" rule applicable to nonprofit hospitals. In view of the commercial involvement of nonprofit hospitals and within the context of the precedence of the current treatment of commercial-type insurance, I propose that the Subcommittee consider extending the "scope and nature" test of section 501(m) to all commercial-type activities of nonprofit hospitals and of other public-benefit nonprofits. It would deny tax-exempt status if a substantial part of a nonprofit's activities consisted of commercial-type activities. It would tax the commercial-type activity in the same way that taxable corporate business is taxed. It would exempt sales or the provision of services provided at a price substantially below cost to a class of charitable recipients. It would establish the policy of "private marketization without tax subsidy" of all commercial-type activities of nonprofits. It would strengten the policy of granting tax exemption to nonprofit activities which have social value not obtained in the private marketplace.

The Competitive Advantage Issue

The proposal and the expansion of the "scope and nature" test would be a major improvement over the existing "relatedness" test toward resolving the competitive advantage issue, because it would extend taxation to related commercial activity as well as to unrelated commercial activity.

On the question of competitive advantage, I believe the public-benefit nonprofits, including hospitals and other health care institutions such as nursing homes, have an advantage over profit-seeking organizations engaged in the same income-producing activity. To begin with, nonprofits apparently have a competitive advantage, even without reference to tax exemption. First, the public generally presumes that nonprofit managers of hospitals, nursing homes, and other public-benfit organizations, because they are guided by the service ethic rather than the commercial ethic, have a greater incentive to provide quality service at a reasonable price. Secondly, public-benefit nonprofits appear to have lower labor costs from a lower wage scale and from the use of volunteer workers. Thirdly, public-benefit nonprofits enjoy subsidies in the form of government grants and private donations which finance their current operations or their expansion. These advantages of the nonprofit form have even led some to question the need for tax exemption in the first place.

Tax exemption provides additional competitive advantages, especially where a public-benefit nonprofit, such as a hospital, carries on commercial-type activities. The nonprofit could engage in price cutting because tax-free profits could cushion lower profit margins. Even if the nonprofit does not engage in price cutting, it could offer better service at the market price. Even if the nonprofit engages in no price cutting and offers the same product at the market price, the fact that it could make a tax-free profit, encourages entry into the market and gaining a market share at a cost to competitors. The fact that a nonprofit can expand from tax-free retained profits is an advanatge if competitors have to pay tax. The recent growth of commercial-type incomes among nonprofits and their ability to repay loans from tax-free income often makes nonprofits preferred borrowers. Finally, tax exemption enables nonprofits to outbid profit-seeking firms for land, location, and facilities. This phenomeon was recognized by the Congress in 1950 when it stated that "the exempt organization, because of its tax-free status, can afford to pay the higher price [than would be paid by a taxable business] and still make a profit on the transaction."

Conclusion

To conclude, Mr. Chairman, the proposal to expand section 501(m) to deny tax exemption to commercial-type activity of nonprofit hospitals would be a major change requiring careful study of its impacts. But it would only be a partial response to your broad inquiry "whether current rules set forth proper standards for determining whether income-producing activities are being appropriately taxed." In that respect, in the interest of consistency and equity, the proposal should also be examined and studied with reference to commercial-type activity of all other public-benefit nonprofits under sections 501(c)(3) and 501(c)(4).

Mr. Flippo. Thank you. We will certainly include your entire testimony in the record. Mr. Gray.

STATEMENT OF BRADFORD H. GRAY, PH.D. STUDY DIRECTOR, INSTITUTE OF MEDICINE, NATIONAL ACADEMY OF SCIENCES

Mr. Gray. Thank you. I am Bradford Gray. I directed the Institute of Medicine study, For-Profit Enterprise in Health Care. I would be glad to provide the committee a copy of that report. Although we did not specifically study the unrelated business income question, some of our findings may be helpful to you. Although I will draw on the IOM report, the conclusions are my own.

Policy regarding unrelated income in hospitals must be considered in view of the purpose and the behavior of not-for-profit hospitals, which comprise about 65 percent of general hospital beds in the United States. Although the preponderance of private, not-for-profit hospitals can best be explained in historical terms—as the only feasible or most practical way to assure the availability of needed services in many communities—two major societal advantages can be cited. The first is stability. Nonprofit hospitals are privately owned and financed, but they do not face the investor-owned hospital's imperative of generating a maximum return for owners who invested equity capital. Equity capital tends to move from areas where economic returns are low to areas where better returns are expected. The Hospital Corporation of America's announced sale of more then 100 hospitals is a good example.

Nonprofit hospitals, because of their histories, missions, and community ties and because of the restrictions that are built into their nonprofit charters, provide a greater degree of stability, as is appropriate for essential community services.

Second, nonprofit hospitals can be expected to behave in ways that depart from the strict pursuit of economic incentives. This is desirable because of the major flaws in the financing and monitoring of medical care in this country. It is essential that there be hospitals that are willing to provide some services that are not self-supporting or that do not generate a rate of return that would attract investors, including: providing uncompensated care to people who lack means to pay; offering certain needed services even if they are not profitable—depending upon the hospital's location, this might include a 24-hour emergency room, a burn unit, a neonatal intensive care unit, or even an obstetrical unit—engaging in unsponsored research and educational activities; locating in areas where it is difficult to generate satisfactory economic returns.

Now, different nonprofit hospitals engage in these activities to varying degrees. The extent of such activities is poorly measured. Although all nonprofit hospitals do not do as much as they might, in some very important areas not-for-profit hospitals are less responsive to economic incentives than are for-profit hospitals.

For example, not-for-profit hospitals provide proportionally more uncompensated care, particularly in states that have inadequate Medicaid programs and few public hospitals. Not-for-profit hospitals are the locus of most of the Nation's clinical research and educational activities. Not-for-profits offer a much wider range of services and are located in a wider variety of locales. Not-for-profit hospitals have lower markups and charge less.

In my view, the appropriate stance for public policy is to encourage such behavior on the part of hospitals. This can best be done by improving hospitals' accountability for the activities that justify their tax exemptions. It cannot be done by undercutting their ability to finance important services that do not generate income.

Alternative ways for hospitals to finance unprofitable activities are limited and becoming more so.

The easiest but least desirable method is for the institution to cannibalize itself by consuming its assets. This is to steal from the future generation.

The traditional method has been by generating surpluses from the treatment of paying patients and using these surpluses for purposes that do not support themselves. A measure of this comes from a recent analysis by the Prospective Payment Study Commission. The median hospital's margins on Medicare patients in the first year of prospective payment was 11.6 percent just on Medicare patients alone. However, their total patient care margins was only 2.5 percent. It is apparent from these numbers that on their non-Medicare patient care, hospitals lost money. This so-called Robin Hood financing will become more problematic as Medicare squeezes down on its rates and as price competition becomes more pronounced in the private sector.

Endowments might be a good source of revenues with which to finance unprofitable activities. However, few hospitals have access to endowment income. Charitable contributions used to be an important source of funds for hospitals, but they have now declined to less than one-half of 1 percent of hospital revenues.

There is one source of income that I have not yet mentioned—revenue from non-patient-care sources, much of which is presumably classified as unrelated business income. Although nonpatient revenues now provide a very small proportion of hospital revenues, it is the only source of revenue that has potential to be greater in the future than it is today. Thus, unrelated business income may become increasingly vital to hospitals' ability to provide uncompensated care, offer unprofitable services, or engage in unfunded research and educational activities.

In summary, hospitals' ability to engage in socially important but nonremunerative activities in the future will depend on their ability to generate income from sources other than patient care, the source of 95 percent of their revenues. It is appropriate that taxes be paid on activities that do not fall within the purposes for which nonprofit organizations are chartered. It is also desirable that hospitals provide more documentation about the nature and extent of their nonremunerative activities. However, in my view, public policy should be concerned with encouraging and facilitating such activities by hospitals, not with inhibiting their ability to engage in them.

Thank you.

[The report referred to follows:]

SPECIAL REPORT

FOR-PROFIT ENTERPRISE IN HEALTH CARE

The Institute of Medicine Study

HEALTH CARE is undergoing a major and often troubling transition. The once dominant structure of community not-for-profit hospitals and their independent, largely solo-practitioner medical staffs has undergone many organizational transformations. Multi-institutional systems have proliferated. Solo medical practitioners have become the exception, and a wave of physician entrepreneurship, often involving economic arrangements with health care institutions, has provoked concern about conflict of interest and fiduciary responsibility. New types of entities, ranging from ambulatory care centers to preferred provider organizations, have been created. Old boundaries are blurring as organizations increasingly provide different levels of care, become involved in both financing and providing care, and form for-profit/not-for-profit hybrids.

Although all these changes have been subjects of controversy, none seems to have touched raw nerves more than the emergence and rapid growth in the past 20 years of a new type of explicitly for-profit entity in health services — the investor-owned corporation.[1-3] Among not-for-profit representatives and some legislators, concern has spread that such organizations, which have to produce a satisfactory return on stockholders' investments, would become excessively commercialized at the expense of quality of care, education, research, access to care for the indigent, and the fiduciary responsibilities of physicians.

Such concerns have been vented in innumerable forums, but clearly the tensions have not been resolved. Policy issues have arisen on which the interests of the for-profit and not-for-profit sectors diverge. For example, some advantages enjoyed by for-profit hospital companies, such as the Medicare-reimbursement advantages of old rules for revaluing acquired assets for purposes of depreciation and Medicare return-on-equity payments, have attracted attention and have been changed. But not-for-profit institutions too have found themselves on the defensive. Utah's Supreme Court created a test that not-for-profit hospitals may have to pass in order to remain exempt from county taxes. In Congress, tax-exempt bonds are being reexamined; indeed, the status of tax-exempt hospitals is coming under review.

The hopes and fears stimulated by the increase in both investor-owned health care companies and in the commercial behavior of physicians led the Institute of Medicine (IOM) in 1983 to initiate a major study, which has culminated in the publication of *For-Profit Enterprise in Health Care*.[4] The report is based on published literature, a public hearing, case studies, original commissioned research, and deliberations over a two-year period by a study committee that contained a broad range of expertise and interests. The study examined (1) the growth of for-profit ownership of health care organizations, (2) relative access to capital in for-profit, not-for-profit, and government-owned hospitals, (3) expenses and costs to payers in for-profit and not-for-profit health care organizations, (4) quality of care in each, (5) the provision of uncompensated care to patients in each, (6) the extent of involvement of each type of hospital in education and research, and (7) how entrepreneurial trends in health care may be affecting the fiduciary responsibilities of physicians. Published with the committee report are 15 papers, including literature reviews, an analysis of the ethics for for-profit health care, and reports of original research on the cost and quality of hospital care, the growth of the hospital-management companies and the effect of their acquisitions, differences in hospital governance and control that are due to type of ownership, physicians' experience with different types of hospitals, and case studies of the operation of different types of hospitals in the same market.

From among these issues, we will review here the study's findings in some key areas — hospital costs, quality, provision of uncompensated care (access), and education and research — and discuss some of the report's policy implications. Although the report is concerned with the growth of investor ownership among all types of health care providers, such as psychiatric hospitals, health maintenance organizations, free-standing ambulatory care centers, and long-term care facilities, the majority of available data comparing for-profit and not-for-profit health care organizations pertain to hospitals. It is important to note that comparative data are not yet available on hospitals' responses to prospective payment systems in the public (Medicare) and private sectors.

The debate about for-profit health care is fueled as much by values as by evidence. Some objections to for-profit health care stem from the belief that it is fundamentally inconsistent with the values and purpose that should animate health care organizations and with primary goals of applying biomedical science on behalf of the needs of patients and communities. Such goals inevitably require health care providers to depart from the rational, profit-maximizing behavior that for-profit organizations are commonly assumed to engage in. The opposing view holds that many human wants and needs are met by for-profit organizations, that for-profit organizations have a kind of "bottom-line" discipline and responsiveness to markets that is difficult for not-for-profit organizations to match, and that investor-owned organizations' sources of capital are an important alternative that should not be dismissed.

The For-Profit/Not-for-Profit Distinction

Most expectations of behavioral differences between for-profit and not-for-profit institutions stem from basic legal differences between these two types of private corporations.[3] Not-for-profit organizations are chartered for limited purposes — charitable, educational, scientific, benevolent, or religious — for which their assets and income must be used. Their boards are typically voluntary. They are generally exempted from federal, state, and local taxes. For-profit (taxpaying) organizations are owned by and accountable to investors, to whom profits ultimately go in the form of dividends or increased stock value. This ownership interest or property right in the for-profit organization's economic performance explains the common expectations of greater efficiency and less willingness to provide unprofitable services or to serve patients of uncertain ability to pay. Although access to equity capital from investors distinguishes for-profit organizations from not-for-profit (as well as public) institutions, the major sources of capital for all types of hospitals in recent years have been debt and retained earnings.[5] For revenues, data from the American Hospital Association show that both types of institutions rely primarily on payments for the services they provide; only about 0.5 percent of the average not-for-profit hospital's revenues (and virtually none of the for-profit hospital's revenues) comes from grants and charitable contributions.[4,6]

For-profit health care organizations are of two types: independent, proprietary institutions that typically are owner operated, and institutions that are part of investor-owned multifacility systems whose stock is generally publicly traded and whose owners therefore usually have little if any direct contact with the institution. Although investor ownership of hospitals has elicited much attention, only 13 percent of all hospitals and 9 percent of all beds are investor-owned. Because the largest companies have grown primarily by acquiring other for-profit hospitals rather than by constructing new hospitals or acquiring public or not-for-profit hospitals, the percentage of hospitals that are for-profit has changed little since the mid-1960s. However, because of their size, resources (both economic and political), ambitious growth strategies, and centralized control of multiple institutions, the importance of the investor-owned hospital companies should not be minimized; they "are to the old 'doctor's hospitals' what agribusiness is to the family farm."[3]

The Committee's Findings

Costs of Care

Studies of hospitals provide no evidence to support the common belief that investor-owned organizations are less costly or more efficient than are not-for-profit organizations. With one exception[7] all available studies that have controlled for many confounding factors (including distinguishing investor-owned from independent proprietary hospitals) show the opposite to be true.[8-11] Most studies show that expenses incurred per day by investor-owned hospitals in caring for patients are higher (from 3 to 10 percent) than in not-for-profit hospitals, although differences in expenses per case are smaller or negligible. Collections per case from cost-based payers (as under Medicare before the diagnosis-related group [DRG] system was instituted, and under many Blue Cross plans) have been from 8 to 15 percent higher in investor-owned chain hospitals than in not-for-profit hospitals; the difference is even larger (17 to 24 percent) in prices paid by charge-based payers. In short, there is good documentation of the relative expensiveness of investor-owned hospitals in the era leading up both to the Medicare DRG system and to the most recent efforts of other payers to control their costs.

As payers impose more constraints on the prices they will pay, investor-owned hospital companies face more of a challenge than often is recognized. The reasons for their past cost disadvantages include higher capital costs (reflecting growth strategies under cost-based reimbursement), central office costs, greater use of ancillary services, and lower occupancy rates. On the other side, not-for-profit institutions have greatly increased their involvement in various types of multi-institutional arrangements that provide benefits of economies of scale in purchasing and access to managerial tools and expertise. The for-profits' major cost advantage has been shorter lengths of stay, but that could be due to regional factors rather than to quicker discharge of patients. Whether other cost advantages will emerge in the new environment for reimbursement remains to be seen. However, not-for-profit hospitals' tax exemptions and their greater access to revenues other than those from patient care amount to an advantage equivalent to perhaps 6 to 8 percent of revenues, a factor that will be of greater importance in an era of increasing cost constraint and price competition.

Access to Care

The activities of investor-owned health care companies in construction and acquisition have probably made services more readily available to the people whom they serve. Public concern, however, focuses not on access to care among well-insured patients who are the object of marketing efforts, but on access among patients who lack means to pay. It is feared that for-profit health care exacerbates the longstanding, unsolved problem of ensuring that these people can obtain needed medical care. The dimensions of this problem, which only begins with the 35 million people who lack adequate insurance coverage and who are not eligible for public programs, have been well documented.[12-16] The care of the indigent in many cases depends on providers' willingness to perform services while knowing that payment may not be forthcoming. Providers must make up the resulting losses with revenues from other sources — often from paying patients. Because the purpose of an investor-owned organization is to make money, understandable doubts exist about the willingness of such organizations to provide uncompensated care.

The evidence, unfortunately, rests on two unsatisfactory measures of service to patients who are unable to pay: the percentage of patients served who are uninsured, and the level of uncompensated care provided (losses due to bad debt and charity care, expressed as a percentage of total patient revenues), which averaged about 4.5 percent among all hospitals in 1982.[16] National data from a 1981 survey by the Office for Civil Rights show that levels of service to uninsured patients in not-for-profit hospitals are higher than in for-profit hospitals (7.9 vs. 6.0 percent, in relation to all patients).[17] Regarding uncompensated care, national data from American Hospital Association surveys[16,18] and from the State of California[4] show little or no difference between for-profit and not-for-profit hospitals, suggesting either that concern about for-profit hospitals has been exaggerated or that not-for-profit hospitals often do not fulfill their assumed social mission.

However, the IOM committee also obtained data from four other states — Florida (1982), Tennessee (1983), Texas (1983), and Virginia (1982) — in which, as in California, more than 30 percent of hospitals are for-profit. In these four states, levels of uncompensated care in investor-owned hospitals ranged from 3.4 to 3.8 percent of gross patient-care revenues, whereas the levels in not-for-profit hospitals ranged from 5.5 to 9.0 percent.[4] Such differences could be caused by factors (the size or location of an institution, for instance) other than willingness or reluctance to turn away uninsured patients untreated. But the majority of the committee agreed that the comparatively low levels of uncompensated care in investor-owned hospitals that constitute 30 to 40 percent of the hospitals in a state suggest that the presence of such hospitals lessens access to care among people who lack means to pay, and may exacerbate the difficulties faced by hospitals that serve such patients.

Public policy cannot rely indefinitely on the ability and willingness of health care institutions to generate the funds needed to provide care for those who are unable to pay. Hospitals have very limited income from sources other than patient-care revenues, and payers are becoming less willing to pay rates that allow hospitals to subsidize care of patients who do not pay. The solution to the problem of access will ultimately require new revenues from government at the federal, state, or local level. In the meantime, greater attention should be paid to ensuring continuation of the historical missions of institutions that change ownership, to the use of taxes paid by tax-paying health care organizations to improve access, and to the requirements for tax-exempt status.

Quality of Care

Most of the limited indicators of hospital quality that are now available — primarily hospital accreditation, board certification of staff physicians, and number of nursing personnel — show no overall pattern of either inferior or superior quality in investor-owned chain hospitals as compared with not-for-profit hospitals. A study done for the IOM committee found that physicians tend to have less-favorable attitudes toward for-profit than not-for-profit hospitals; almost one fourth of physicians with privileges in for-profit hospitals said that they believed that quality of care was better in the not-for-profit sector. However, for most measures of quality, including outcome of elective surgery, evaluated in a study done for the IOM committee, differences between investor-owned and not-for-profit hospitals were small, and the direction of the differences was not consistent. There is also some reason to believe that acquisitions by investor-owned hospitals have improved quality of care, both because capital improvements have been made at many facilities and because accreditation rates among investor-owned hospitals are much higher than among independent proprietary hospitals, which have been their primary source of acquisitions.

However, quality of care should be of continuing concern both because of the limitations of the measures on which the IOM committee had to rely and because of the changes in hospital reimbursement that have encouraged economies that could reduce quality of care. Although comparisons between nursing homes and hospitals have many limitations, the history of problems with quality in nursing homes, which are largely paid according to prospectively set rates and which have long been mostly for-profit, gives emphasis to this concern. The committee concluded that the organizational, economic, and competitive changes taking place in health care make imperative increased monitoring (by regulators and purchasers of care) of health care outcomes in all types of settings, including hospitals and free-standing centers, both for-profit and not-for-profit.

Education and Research

Until recent years, investor-owned health care companies have had little involvement in health professional education or unsponsored research, although they have benefited from both. Charges of unfair competition and social irresponsibility have been leveled, although the companies contend that most of the hospitals that they have acquired (and that were available for acquisition) had never had education and research programs. More broadly, the desirability of subsidizing education and research out of patient-care revenues can be questioned.

Recently, investor-owned companies have become involved in a modest way in education and research by acquiring or leasing a handful of teaching hospitals and by planning construction of three or four more. Although these developments are stimulated by a mutuality of interests and goals on the part of institutions and the companies, concerns have arisen about th compatibility of stockholder interests and the valu and interests of faculty. Experience is too limited permit an informed opinion.

Further Implications

The evidence of investor-owned hospitals' disa vantages in regard to costs (under circumstances th have substantially changed) and uncompensated care (a problem that must be dealt with more broadly) has been described. The IOM committee also said, however, that for-profit organizations have brought new sources of capital to health care, that some of their activities in acquisition and construction have probably preserved or enhanced the availability of services, and that they have contributed to and provoked competition and change in the health care system. All these points require qualification — and some committee members felt that they were more rhetorical than real. However, on the basis of its data and deliberations, a majority of the committee concluded that the available evidence is not sufficient to justify recommending that investor ownership of health care organizations be either opposed or supported by public policy. (In a supplementary statement, some committee members expressed reservations about investor ownership.) The importance of health care for all people, but particularly for those with few resources, is too essential to a nation's well-being and to people's welfare to be left wholly to the marketplace. Substantive goals regarding cost, quality, access, education, and research are more appropriate than a goal of creating fair competition between for-profit and not-for-profit health care organizations.

The presence of for-profit organizations in an increasingly competitive health care system heightens the importance of several policy issues — the nature of the economic incentives in the payment system, social responsibilities of health care institutions, functions and viability of not-for-profit institutions, care for people who are unable to pay, policy on capital, and the future of the physician's fiduciary role, among other matters. We can deal only selectively with these issues here. The traditional view of the basic moral purpose and mission of health care institutions begins with meeting the needs of the sick. However, all hospitals face economic realities, and as complex organizations they follow many agenda. Seeing that people who need care obtain it, regardless of their ability to pay, often has not been the first priority. However, the presence of health care institutions whose explicit purpose is to make money gives this point an emphasis that many observers find disquieting.

The IOM report emphasizes the importance of putting the patient's interest first. From this several points follow. One is that investor-owned health care organizations have social responsibilities beyond those that typify the for-profit world. Health care is and should be a major concern of public policy, and sick people have particular vulnerabilities. If for-profit organizations impede practical efforts of other institutions or of local, state, or national government to deal with problems in the provision of health services, they will increasingly be seen by the public as part of the problem. The for-profit sector, in its own interest, should resist the temptation to let its tax obligations exclusively define its social or moral obligations, particularly since tax-supported programs fail to ensure the availability of funds to meet the needs of people who lack means to pay.

However, the issue of social responsibility is in no way limited to the for-profit sector. Questions are being raised about obligations that might follow from the tax-exempt status of not-for-profit health care institutions. The IOM committee concluded that the amounts of charitable contributions that an institution receives, plus the amount of taxes that it does not have to pay by virtue of its tax-exempt status, should be reasonably related to the amount of uncompensated service that it performs in the form of charity care, unprofitable standby capacity, unsponsored research, and institutionally subsidized educational activities.

In a more competitive health care system in which third-party payers are finding ever more creative ways to limit their expenditures, particular concern is warranted about the continued vitality and even the survival of important not-for-profit and public institutions that provide large amounts of uncompensated care and are valuable centers of education, research, and tertiary care. The problem of caring for indigents involves more than people who need services but lack means to pay; it is increasingly a problem for institutions that, because of their values or location, attempt to meet such needs, often while shouldering teaching and other responsibilities. If institutions are forced by economic circumstances to restrict themselves to activities that contribute to "the bottom line," values of incalculable importance will be degraded.

For these reasons, the IOM report emphasizes the importance of developing means of financing care for indigents and preserving the unique functions of teaching hospitals, and of meeting the future capital requirements of institutions that lack access to the equity market. On this latter point, the report calls attention to the importance of continued Medicare payments for capital, acknowledges that such payments can reasonably be incorporated into prices under a prospective payment system, and emphasizes the key role of tax-exempt bonds as a source of capital for the not-for-profit sector. From a standpoint of public policy, however, it would be appropriate if eligibility for tax-exempt debt were tied to provision of uncompensated care, unprofitable services, or education and research.

The final emphasis of the IOM report is on the physician's role as a fiduciary or agent of patients. This role is becoming more complicated as a result of technological changes, mounting economic pressures, and new health care organizations. In view of increasing entrepreneurial activities and joint ventures involving physicians, the committee calls for close attention to, or in some cases active discouragement of, such practices as physicians' making substantial capital investments in technology and equipment whose utilization they control, owning an interest in organizations to which they make referrals, and receiving bonuses from hospitals for taking actions that enhance hospital revenues.

The report also calls for maintaining physicians' influence in hospitals and allied institutions, to ensure that concerns about patient care are not subordinated to economic concerns and that quality of care is not compromised. This vigilance will become more necessary as multi-institutional frameworks grow and as decision making becomes more centralized in a managerial environment.

CONCLUSION

Difficult challenges face both the for-profit and not-for-profit sectors, and not all organizations will survive. Because of their historically higher costs, their tax obligations, and their more exclusive reliance on patient-care revenues, investor-owned hospital companies face tough choices. They achieved their growth and wealth in a very different environment for reimbursement. Profits will be harder to come by in the future, but stockholders will be no less demanding. Avenues to future profitability contain obvious dangers to the public and to investor-owned chains. Measures toward efficiency can affect quality of care, and therefore the welfare of patients as well as corporate reputations. Past success in operating hospitals under cost-based reimbursement provides no assurance that companies (or not-for-profit organizations) will be able to compete effectively in the highly competitive insurance marketplace into which several health providers are moving.

The challenge to not-for-profit institutions is not only how to deal with new and difficult economic realities, but how to do it so that the community functions that many hospitals have performed over many years are preserved. Data reviewed in the IOM study show that the increasingly common observation that the activities of some not-for-profit hospitals can hardly be distinguished these days from those of their investor-owned competitors may be true in some ways (e.g., the growth of multi-institutional systems and for-profit subsidiaries) but not true in others. If it becomes more difficult to distinguish not-for-profits from for-profits, the former will have a more difficult struggle to maintain their credibility, support, and tax exemptions. Given the central place of not-for-profit institutions in American health care, this may be the matter about which most concern is warranted.

The current path toward an increasingly competitive environment, with more investor ownership, more for-profit activities by not-for-profit institutions, and larger multi-institutional networks, raises many issues that warrant careful monitoring and study. Beliefs vary about whether investor ownership will peak shortly, whether the recent downturn in equity values of hospital chains is permanent, whether public infatuation with a new market has cooled, and whether the for-profit sector will remain a minority influence or will become more dominant. There are signs that some momentum of for-profit institutions has been lost as management tries to cope with an increasingly competitive market.

As important as ownership is, we believe that in the last analysis it is a surrogate for more basic, underlying public concerns. In the face of deregulation and privatization in several fields — banking, transportation, and welfare — the public may be coming to the uneasy realization that there are no quick remedies, that old problems are replaced by new ones. In the health field, public and private buyers of care are beginning to understand the complexities of designing incentives to achieve effectiveness, just as only a few years ago they came to understand better the limitations of regulation in balancing the interests of institutions and communities.

Given the state of flux and the disputed importance of ownership as a critical factor, our major focus as a nation must be on outcomes — on the condition of the uninsured, the quality of care, the excellence of education and research, and the fiduciary role of the physician. This focus will require a new dedication to monitoring and evaluation, and more responsible public policies than we have at the moment. As a nation, we should feel uneasy — less because of potential investor venality than because markets need legislative and regulatory support to work, especially for essential human services, in which the needs of those without resources cannot otherwise be met.

Institute of Medicine
National Academy
of Sciences
Washington, DC 20418

BRADFORD H. GRAY, PH.D.
WALTER J. MCNERNEY, M.H.A.

Address reprint requests to Dr. Gray at the Institute of Medicine, 2101 Constitution Ave. NW, Washington, DC 20418.

This article is based on *For-Profit Enterprise in Health Care*, an Institute of Medicine committee report that is for sale by the National Academy Press, 2101 Constitution Ave. NW, Washington, DC 20418. Committee members are Walter J. McNerney, M.H.A. (chairman), Karl D. Bays, M.B.A., John C. Bedrosian, LL.B., Roger J. Bulger, M.D., Alexander M. Capron, LL.B., Robert A. Derzon, M.B.A., Eliot Freidson, Ph.D., John K. Kittredge, Alan Levenson, M.D., John H. Moxley, III, M.D., Stanley R. Nelson, M.H.A., Kenneth A. Platt, M.D., Uwe E. Reinhardt, Ph.D., Arnold S. Relman, M.D., Steven A. Schroeder, M.D., Stephen M. Shortell, Ph.D., Katharine Bauer Sommers, Rosemary Stevens, Ph.D., James Todd, M.D., James Wallace, CPA, Daniel Wikler, Ph.D., and Donald C. Wegmiller, M.H.A. Staff: Bradford H. Gray, Ph.D. (study director), Jessica Townsend, M.H.A., and Sunny Yoder, M.A.

REFERENCES

1. Relman AS. The new medical-industrial complex. N Engl J Med 1980; 303:963-70.
2. Starr P. The social transformation of American medicine. New York: Basic Books, 1982.
3. Gray BH, ed. The new health care for profit. Washington, D.C.: National Academy Press, 1983.
4. Institute of Medicine. For-profit enterprise in health care. Washington, D.C.: National Academy Press, 1986.
5. Cohodes DR, Kinkead BM. Hospital capital formation in the 1980s. Baltimore: Johns Hopkins University Press, 1984.
6. Hansmann HB. The role of nonprofit enterprise. Yale Law J 1980; 89:835-901.
7. Sloan FA, Vraciu RA. Investor-owned and not-for-profit hospitals: addressing some issues. Health Affairs 1983; 2(1):25-37.
8. Lewin LS, Derzon RA, Margulies R. Investor-owneds and nonprofits differ in economic performance. Hospitals 1981; 55(13):52-8.
9. Pattison RV, Katz HM. Investor-owned and not-for-profit hospitals: a comparison based on California data. N Engl J Med 1983; 309:347-53.
10. Becker ER, Sloan FA. Hospital ownership and performance. Econ Inq 1986; 23:21-36.
11. Watt JM, Derzon RA, Renn SC, Schramm CJ, Hahn JS, Pillari GD. The comparative economic performance of investor-owned chain and not-for-profit hospitals. N Engl J Med 1986; 314:89-96.
12. Robert Wood Johnson Foundation. Updated report on access to health care for the American people. Princeton, N.J.: Robert Wood Johnson Foundation, 1983.
13. U.S. Bureau of the Census. Economic characteristics of households in the United States: Fourth Quarter 1983: Current Population Reports, P-70-83-4. Washington, D.C.: Government Printing Office, 1985.
14. Farley PJ. Who are the underinsured? Milbank Mem Fund Q 1985; 63:476-503.
15. Iglehart JK. Medical care of the poor — a growing problem. N Engl J Med 1985; 313:59-63.
16. Sloan FA, Valvona J, Mullner R. Identifying the issues: a statistical profile. In: Sloan FA, Blumstein JF, Perrin JM, eds. Uncompensated hospital care: rights and responsibilities. Baltimore: Johns Hopkins University Press, 1986:16-53.
17. Rowland D. Hospital care for the uninsured: an analysis of the role of proprietary hospitals. Presented at the annual meeting of American Public Health Association, October 1984.
18. American Hospital Association. News release. February 6, 1985.

Mr. **Flippo**. Thank you very much. You know, I believe our subcommittee chairman is returning; and I am very reluctant to begin the testimony of Mr. Pfister at this time because I believe your testimony is not directly related to our other two panels.

Mr. Pickle will return very soon, and we would like to have you testify separately. So I think at this time maybe we should direct our questions to our two panelists and let me say that we have 7 or 8 minutes, so we will question for a couple of minutes and then have to go vote, but if Mr. Pickle is here we will continue the hearings.

We seem to have a basic conflict in the testimony of our panelists here today in the sense that I believe Mr. Rudney, you are suggesting by your testimony, if this is not correct, correct me. You are suggesting that the commercialization activities in fact are so extensive as to threaten the primary purpose for the tax exemption, where I believe Mr. Gray, you are saying, that what we should be doing is encouraging not-for-profit hospitals to engage in activities that will enable them to perform services for which they cannot adequately recover their cost.

Is that a fair——

Mr. **Gray**. I was trying to focus less on the way that they raise the funds and more on holding them accountable for the ways that they expend the funds.

Mr. **Flippo**. I see. Could each of you—would you care to comment on Treasury's recommendations as to how this committee approaches the solution to this problem, Mr. Rudney?

Mr. **Rudney**. Mr. Chairman, I would like to comment on one that perhaps comes closest to the proposal that I have made. Treasury in its presentation to you indicated that one of the areas it felt the subcommittee should consider was the substantially related test. I would like to read one sentence of the Treasury's testimony, which indicates to me why my proposal has a certain advantage. I quote from the testimony after their discussion of the substantially related test—"the practical result appears to be an ad hoc test that in many cases offers inadequate guidance to the courts, exempt organizations and revenue agents."

My proposal takes that into consideration and substitutes a "commerciality" test for the substantially related test. It has wider impact, but I have already discussed my rationale for the test. That is just one comment I can make on the Treasury's testimony.

Mr. **Flippo**. Mr. Gray, do you have a comment?

Mr. **Gray**. Many of the things in the Treasury recommendations were technical issues about which I have no particular expertise. It does seem to me that there are a number of matters that aren't clear and to the extent Treasury called for clarification and for collection of additional information and for learning more about certain things, that seems to me to be well-founded.

I didn't really come this morning prepared to comment on the overall issue of whether the tax exemption for nonprofit hospitals is something that should be rethought. I think Mr. Rudney's testimony primarily went to that question. I would make a couple of comments on that in view of that. It seems to me that the primary advantage of nonprofit status for hospitals are their tax exemptions. The long drift of payment of hospital services in this country has continually increased the proportion of patients that are covered by insurance and now we have reached the point where about 95 percent of hospital revenues comes from the sale of hospital services to people who have insurance or who pay for it themselves.

I am not sure whether that is the commercial activity that Mr. Rudney is referring to, but hospitals in that sense are commercial enterprises. However, if we want to keep capital in health care and not moving to areas where it may produce a greater return, then I think there is a societal interest in having nonprofit hospitals, and I think that the tax exemption is the primary advantage of being nonprofit.

Otherwise there is not much reason to be nonprofit. I could extend that, but it seems to me that that may be on a topic other than the main hearing today.

Chairman PICKLE. I would ask you to submit commentary about the seven areas within which Treasury has recommended changes. You have mentioned one or two of the areas. So that we might have your overall views, would you please submit comments on the other areas please? I don't have any other statements at this point.

[The following was subsequently received:]

Yale University

Program on Non-Profit Organizations
Institution for Social and Policy Studies
P.O. Box 154 Yale Station
New Haven, Connecticut 06520-7382

Campus address:
88 Trumbull Street
Telephone:
203 432-

July 31,1987

The Honorable J.J. Pickle, Chairman
Subcommittee on Oversight
Ways and Means Committee
House of Representatives
U.S. Congress
Washington, D.C.

Dear Mr. Chairman:

In response to your request for further information during your Oversight Subcommittee's hearings on the tax treatment of income-producing activities of nonprofit organizations, Professor James Bennett of George Mason University and I are submitting the attached statement for your Subcommittee's consideration.

Professor Bennett and I testified separately before your Subcommittee. We found that we came essentially to the same conclusion about commercial activities of nonprofits. While we recognize the validity of the rationale for tax exemption of nonprofits for their charitable and other specified purposes, the rationale should not apply to their commercial activities. Yet much of nonprofit commercial activities is tax-free largely because of widespread interpretation that such activities are related to exempt purposes under the "relatedness" test. Moreover the test has proven to be quite problematical by not resolving issues of competition with for-profit business. In fact, to a large extent, the test has aggravated competitive issues because of the rapid expansion of related commercial activiies. In that respect, the test is open-ended. No doubt, it is this open-endedness that led you and other members, including Congressmen Rangel, Schultze, and Thomas, to express concern during the hearings, about virtual nonexistence of limitations on tax-free commercial activities of nonprofits.

We do not object to commercial activities by nonprofits per se, but to government subsidization of such activities by tax exemption. Accordingly, we have in the attachment structured and justified a "commerciality" test to replace the existing "relatedness" test for your Subcommittee's consideration.

If we can be of further assistance, please call on us. Professor Bennett can be reached at 703-323-2744. I can be reached at 202-362-6046.

Sincerely yours,

Gabriel Rudney

Gabriel Rudney
Research Affiliate

A COMMERCIALITY TEST TO RESOLVE THE COMMERCIAL NONPROFIT ISSUE

by James Bennett and Gabriel Rudney*

July 31,1987

We recognize the validity of the rationales for tax exemption of nonprofits for their charitable and other specified purposes. These rationales do not apply to their commercial activities. We do not object to their commercial activities *per se*, but to government subsidization of commercial activities.

A commerciality test, structured here, is submitted to the House Ways and Means Subcommittee on Oversight for consideration as a replacement of the problematical relatedness test which has been applied for almost four decades to determine the tax status of commercial activities by nonprofits. Replacement of the relatedness test would be a major departure from existing law, and would constitute a reformation of the tax exemption of nonprofit organizations with regard to their commercial activities. It requires thorough examination and evaluation.

Today, public-benefit nonprofits (IRC Sections 501(c)(3) and 501(c)(4)) and other 501(c) entities operate commercial activities which are tax-free. The activities are deemed tax-free, because, under the law, they are found to be related to the tax-exempt purpose of the nonprofit. The test of "relatedness" is unacceptable within the context of the nonprofit-commercial complex that exists today, for the following reasons:

1. The tax status of the income-producing activities of nonprofits should be based on the fundamental principle and Constitutional guarantee of "equal treatment under the law." The test should be the commercial nature and scope of such activity, not the relationship of the income-producing activity to the exempt purpose of the organization. Commercial activities of nonprofits are carried on in the marketplace in competition with taxpaying firms. There is no justification for subsidizing such private market activity by treating the entity's commercial activity as tax-free.

It is also noteworthy that nonprofits enjoy preferential treatment in such areas as state and local taxation, postal rates, eligibility for government contracts and grants, unemployment insurance, fair labor standards, antitrust and securities regulation, and exemption from the jurisdiction of the Federal Trade Commission.

---

*James Bennett is Professor of Economics at George Mason University. Gabriel Rudney is Research Affiliate at Yale's Institution for Social and Policy Studies.

2. The current application of the relatedness test to income-producing activities creates public controversy about competitive advantage of nonprofits in the marketplace. The privilege of tax exemption now accorded income-producing activities of nonprofits lowers their costs of production relative to their for-profit counterparts.

Futhermore, the availability of tax exemption is a competitive advantage because it permits leveraging with debt-financed investment. For example, tax-free income of debt-financed real estate gives nonprofit institutions a competitive advantage in purchasing real property for investment. The market rate of after-tax income can be achieved by the institution with a lower before-tax rate of income. Thus, the institution can pay a higher purchase price than taxable investors because the institution can capitalize the flow of income from the real estate at a higher rate than taxable investors.

3. The relatedness test provides little or no effective means of limiting tax-free, income-producing activities of nonprofits. "Relatedness" has become an almost totally open-ended test by ascribing a "public-welfare or community-benefit" or "industry- or profession-benefit" destination or purpose to the "profits" of income-producing activities. This broad interpretation of relatedness provides little or no restriction of the scope of tax-free commercial activities. It is, in fact, not uniquely justifiable, because private market activities of taxable profit-seeking firms also provide public and community benefits, or industry or profession benefits. If the intended use of "profits" from nonprofit commercial activities is to support the exempt purposes of nonprofits, the support should be after-tax.

Moreover, with little current limitation on expansion of income-producing activities, the tax base of the corporate income tax, which is now eroded by tax-free commercial activities, could become more seriously eroded in the future by widespread expansion of nonprofit commercial activities. A case which reflects this concern is the recent Congressional decision to totally limit certain tax-free insurance activities of nonprofits by enactment of Section 501(m).

4. The tax exemption of related income-producing activities cannot be justified because the current commercial activity is based on past research, innovation, experimentation, or practice of a nonprofit institution. Beyond public recognition of intellectual, creative, and scientific accomplishments, any financial or valuable awards to a nonprofit organization, or nonprofit participation in commercial activity based on such accomplishments should be subject to tax. Furthermore, tax exemption cannot be justfied by nonprofit participation in an evolving market or industry, if in the past no market or industry existed, and nonprofits provided the services.

5. The tax exemption of related income-producing activities creates inefficiencies not beneficial to the economy. It is

highly questionable to grant tax exemption to nonprofits in industries in which they provide no natural advantage or efficiency over for-profit firms. Why give a tax subsidy and forego corporate income tax revenues, if the result simply overpopulates an industry, reduces the market share per firm, and creates public controversy about competitive "unfairness"? Why give a tax subsidy and forego corporate income tax revenue, if the tax-free nonprofit businesses are less efficient than the firms that operate in the absence of the tax subsidy?

Nonprofit management tends to be less efficient because it is guided by operating goals different from profit maximization, such as output or budget maximization. Guided by such operating goals, nonprofit management overinvests and creates excess capacity as is typical of the hospital industry and higher education. Overinvestment is not only an inefficient use of capital, but it also results in excessive borrowing and burdensome interest costs which drain the financial support of the basic exempt purposes of the nonprofits.

Tax exemption of related income-producing activities often results in the concentration of nonprofit investment in one or two businesses, rather than in diversification of investments. Excessive holdings in one or a few businesses increases the risk of loss of funds intended for charitable use and for which a donation deduction is provided at a cost to the fisc. Such concentration could be viewed as imprudent nonprofit management, if the risk of loss is high. It is noteworthy that the lack of "profits" and tax liabilities of nonprofits now operating unrelated businesses or taxable subsidiaries may be viewed as imprudent use of nonprofit resources ultimately intended for charitable or other exempt use.

6. The ambiguity of the relatedness test has created serious compliance and enforcement problems, and has led to questionable legislation by the Congress, to questionable decisions by tax administrators and the courts, and to widespread and emotional petitioning of the Congress by business and nonprofits to obtain fair and equitable tax treatment. Even if the relatedness test were amended, it is unlikely the test could be improved in a manner that would make it sufficiently effective in compliance and enforcement areas, as well as resolve the "unfairness" issue arising from competitive advantage.

7. The relatedness test does relatively little to limit tax-free commercialism. Conversely, the test serves to encourage commercialism and threatens, in public-benefit nonprofits, the basic values of philanthropy and charitable missions. The accelerated expansion of commercialism among nonprofits, which began as a means of supplementing contributions and government support, is converting the fundamental donative or philanthropic character of public-benefit nonprofits into essentially a commercial one. The growth and often dominance of tax-free commercial activities among nonprofit sources of revenue tend to obscure, for nonprofit management and potential donors, the

fundamental purpose of nonprofits for which tax exemption was originally granted. Clearly, commercialism serves to diminish nonprofit management's need to resort to the fundraising process and the encouragement of philanthropic giving.

B. Nonprofit membership, mutual, and cooperative organizations operate to provide goods and services to members and patrons. In the past, tax exemption was justified because for-profit businesses did not adequately provide members or patrons with such needs. Now, frequently, the tax exemption is no longer justified. Nonprofit goods and services are often the same as those provided by taxable businesses. and can be adequately provided in the marketplace by taxable business. The loss of tax exemption of savings and loan associations, mutual savings banks, certain insurance organizations, and automobile clubs, demonstrates Congressional concern in the past about unjustifiable tax-free status of such activities. But anomalies stll exist. For example credit unions remain tax-exempt even though they are virtually indistinguishable from taxable banking institutions.

Features of a Structured Commerciality Test

The commerciality test is intended to replace the relatedness test. The purpose of the commerciality test is straightforward: to determine if an activity of a nonprofit entity is a commercial-type activity. If found to be commercial, the activity's surplus or "profit" is taxable.

Before the application of the commerciality test to the activity of a nonprofit organization , it is assumed that the organization has met the basic tax exemption requirements of the Internal Revenue Code's Section 501(c), i.e., the entity is organized on a nonprofit basis. No part of its net earnings inures to the benefit of any private individual or shareholder. The nonprofit's assets are not used for the benefit of an officer, trustee, shareholder, member, donor, contributor, etc. No part of the proceeds upon liquidation or dissolution of the entity inures to the benefit of a private person.

1. Sale of a service or commodity

The first feature of the test is to determine whether an activity of a nonprofit organization involves sales by the organization of a service or a commodity to:

a. Individuals,

b. Businesses,

c. Governments, and/or

d. Tax-exempt organizations.

2. Sale at a price

Another feature of the test is the determination whether the sale is a transaction involving a price for the service or commodity. The price may be stated in monetary terms or in terms of exchange for a service or commodity provided by the purchaser.

3. Purchaser exercises choice

The test determines whether the purchaser has the option of purchasing the service or commodity at the price or not, and whether the purchaser also has the option of purchasing the service or commodity from another seller (individual, business, government, or tax-exempt organization) at a lesser, greater, or same price. The alternative seller need not be in the same geographical location. For example, if health fitness services sold by a nonprofit is the only health fitness activity in a community, a purchaser may exercise the option of going to another community to purchase health fitness services at a price (including the cost of travel).

4. Seller exercises choice

The test determines whether the nonprofit organization engaged in the income-producing activity has the option to produce and/or to offer the quantity and quality of a service or commodity at a price. The price may be lesser, greater, or the same as the prices set by other sellers. The quantity and/or quality of the service or commodity offered by others may differ from that offered by the nonprofit organization, even though the price is the same.

5. Purchaser may have a third party payor

The service or commodity sold to a user may be paid for by a third party, such as a government program or a private company, as in the case of health insurance.

6. Investment activity

The test determines the extent to which a nonprofit has investment income, such as interest, dividends, rents, royalties, and capital gains and losses. All investment earnings are taxable revenues under the commerciality test, except interest income from state and local bonds.

7. Financing costs

The test determines the extent to which the value of the service or commodity provided is covered by the payment received plus investment earnings. The value of the service or commodity is the sum total of the costs of producing the service or commodity (operating, maintence, etc. expenses). An operating surplus ("profit") or deficit ("loss") may exist in a commercial-type activity. The commerciality test specifies that an activity is commercial-type, if the sale receipts and investment income cover more than 50 percent of the costs of production. An activity is not a commercial-type if more than 50 percent of the costs is covered by private and/or government subsidies. Subsidies include noncommercial revenues (other than sales receipts and investment earnings), such as private donations, government grants, and the value of unpaid volunteers. Investment earnings obtained from taxable activities are not subsidies. Borrowed funds to finance a nonprofit operation or investment are not subsidies. They are commercial funds and are treated the same as sales receipts.

8. Use of operating surplus or "profit"

The use or "destination" of an operating surplus or profit of an activity to finance the operation, maintenance. modernization, or expansion of a charitable activity in the same organization or in another organization, does not make the income-producing activity itself noncommercial.

9. Recipient group or purpose deemed charitable

To be noncommercial, the activity must not only meet the 50 percent subsidization test, but the subsidized services or commodities must also be directed at a specific recipient group or purpose deemed charitable.

10. Public benefit goal need not make activity noncommercial

Income-producing activities of for-profit, as well as nonprofit organizations, often provide public or community benefit. Public or community benefit by itself is not the criterion to determine whether the activity is noncommercial. However, if the activity of a nonprofit organization is substantially subsidized by private donations and/or government grants (that is, subsidization is more than 50 percent of total revenues), then the activity, even though engaged in sales of a service or commodity, provides a gift to the community in its capacity as a conduit of the donations and grants, and is considered not to be a commercial activity.

Chairman **Pickle**. Mr. Pfister, would you like to proceed—have you made your statement?

Mr. **Pfister**. I have not, Mr. Chairman.

Chairman **Pickle**. We will ask you to proceed and perhaps Mr. Rudney and Mr. Gray you would remain at the witness table in case we have questions. Mr. Pfister is chairman of the Arizona Board of Regents and is speaking on behalf of the Association of Governing Boards of Universities and Colleges.

STATEMENT OF A.J. PFISTER, CHAIRMAN, ARIZONA BOARD OF REGENTS, ON BEHALF OF THE ASSOCIATION OF GOVERNING BOARDS OF UNIVERSITIES AND COLLEGES

Mr. **Pfister**. I am appearing in support of the universities and colleges position that no new Federal legislation is required in this area and that current Federal law is well-reasoned as it applies to the universities and colleges and supports our national objectives for higher education.

My written statement expands on the reason for this support and let me briefly report on the Arizona experience in order to try to put into context how serious this problem is. In Arizona, we have a statute which prohibits the competition by the universities and junior colleges with private enterprise and there is a mechanism in Arizona for those small businesses that feel that they are unfairly competing against the universities to file complaints.

In the 6 years that that statute has been on the books, there have been only two complaints that have gone through the entire process and so that would suggest that at least in Arizona the universities are not unfairly competing with small business in any large measure.

However, my own experience in just observing as a member of the board of regents is that the trend of universities is to be more entrepreneurial, so I think there is a tendency, certainly, in Arizona, and I suspect nationally that will cause continuing friction on this issue of competition. For that reason we strongly encourage the collection of more data to try to quantify how serious this problem is.

We believe this trend can be mitigated by rigorous enforcement of the existing laws and with AGB assistance on a readiness to provide more quantitative detail to the committee should that be necessary. Thank you.

[The statement of Mr. Pfister follows:]

TESTIMONY OF

A. J. PFISTER
CHAIRMAN, ARIZONA BOARD OF REGENTS

ON BEHALF OF
THE ASSOCIATION OF GOVERNING BOARDS OF UNIVERSITIES AND COLLEGES

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U. S. HOUSE OF REPRESENTATIVES

REGARDING

UNRELATED BUSINESS INCOME TAX

Mr. Chairman and Members of the Subcommittee:

My name is A. J. Pfister and I am the General Manager of the Salt River Project in Arizona. I am also the Chairman of the Arizona Board of Regents. It is my pleasure to speak to you today about the unrelated business income tax as it affects colleges and universities. I am speaking on behalf of the Association of Governing Boards of Universities and Colleges (AGB), which comprises some 26,000 individuals, more than 40% of whom are business executives, representing the boards of trustees of more than 1,600 colleges and universities.

I am also here today as an individual businessman who has worked with and relied on a strong cooperative relationship with higher education. I am well aware of the complaints that prompted this Subcommittee hearing, and I am concerned that these voices might be interpreted to represent all of the business community.

While there may have been instances when an over-zealous entrepreneur at a college has ventured into a commercial activity in competition with a local business, the current law is adequate to control these. Current law protects the myriad interests of all the concerned groups: businesses; the students, faculty and staff of colleges and universities; and the nation as a whole, which relies heavily on a flexible and expanding system of higher education to foster innovation, stimulate economic growth, and train tomorrow's leaders.

Higher education's activities must be examined within the context of the three important missions of colleges and universities -- teaching, research and community service.

Auxiliary Services

Teaching is the core of higher education, but it cannot be performed in a vacuum. Students and their teachers need a place to live and learn, which includes books, computers, dormitories, dining facilities, and recreational facilities. Colleges and universities traditionally have provided the learning tools and auxiliary services needed by students and faculty.

Colleges and universities make decisions about the products and services to be offered to students and faculty on the basis of educational needs and objectives, not profitability. Colleges do not drop services when they become unprofitable. Conversely, colleges and universities should not be expected to drop services when they become potentially profitable to businesses outside the campus.

A business like my own, on the other hand, cannot provide unprofitable services or undertake activities that do not generate profits. This is a fundamental difference between higher education institutions and for-profit business—a difference that must be remembered as this Subcommittee and Congress examine the issue of unrelated business income tax and competition. Colleges and universities provide services and undertake activities because there is an educational need, not because there is a profit.

Research

Colleges and universities conduct basic and applied research to advance the frontiers of knowledge and to transmit that knowledge to future generations. This research complements the education function of colleges and universities and serves as an essential fundament to the nation's science and technological development. It is well documented that the cooperative effort of government, industry, and higher education together is essential to respond to the nation's immediate and long-term needs. Space exploration, medical research, and a variety of high-technology research efforts, such as superconductivity, have all been undertaken through a sophisticated network of federal and private support of university and industrial research.

Current tax law recognizes and encourages the unique position of colleges and universities to conduct research independent of commercial considerations by excluding such activities from the unrelated business income tax. This federal commitment to the preservation of research for the sake of knowledge, independent of market trends, must be perpetuated.

Community Service

Colleges and universities also contribute significantly to the community. They provide expertise to local small businesses through federally sponsored programs, such as the Small Business Development Centers, or through their own programs. Colleges and universities often respond to local businesses' needs by providing training and retraining of employees as market demands and technological advances create new jobs and make old jobs obsolete. They also reach out to provide educational opportunities to many special community groups such as retirees, exceptionally gifted elementary and secondary students, and handicapped persons.

The Federal Unrelated Business Income Tax

The unrelated business income tax has preserved the proper balance of providing flexibility to colleges and universities to meet the educational purpose for which they are non-profit and protecting the for-profit sector from abuses. The test of "relatedness" allows non-profit organizations to pursue activities within their exempt function and discourages ventures into unrelated areas. The standard has been in place for 35 years and a body of case law is accumulating to aid in making difficult judgments in particular cases.

The unrelated business income tax excludes certain types of passive income and research. The exclusion for certain investment income and investment returns allows colleges and universities to build and maintain endowments that allow an institution to continue providing education during difficult economic times, provide opportunity for exploration of new ideas, offer education to students who otherwise could not afford college, and provide a variety of other essential functions of the learning enterprise as it has evolved.

The second exclusion for research is equally important for colleges and universities. Although the research efforts of colleges and universities would likely be considered to be related to the exempt purpose of the institution anyway, the exclusion in current law should not be changed. The exclusion has become understood by the institutions and the IRS and, in effect, reiterates the nation's commitment to university research activities.

Recommendations

I have not found sufficient evidence to support the charges of some in the business community that colleges and universities are massively abusing the current law relating to unfair competition.

I have heard several anecdotes repeatedly. Indeed, the recent GAO Report, "Competition Between Taxable Businesses and Tax-Exempt Organizations," concluded, "Overall, we found that complete data do not exist to quantify the nature, extent, and impact of competition" between the for-profit and non-profit sectors.

On behalf of the Association of Governing Boards, I encourage Members of this Subcommittee and Congress to study compliance with the current law before altering it. If, indeed, further study shows that some higher education institutions are engaged in profit-making activities that are unrelated to their exempt purposes, then I believe those institutions should be taxed appropriately. I believe that what you will find, however, is a higher education community engaging in proper education activities for the benefit of their multiple and demanding constituencies, one of which is the small business community itself.

The current federal law is well-reasoned. It has also withstood the test of time during a period in which tremendous economic and technological change both challenged and threatened this country's preeminent world position. Colleges and universities have been able in the past few decades to respond quickly and efficiently to the rapidly changing demands of society in part because their activities have not been unduly restricted.

Finally, on behalf of the Association of Governing Boards, I endorse and commend to your attention the excellent written statement submitted to you by the American Council on Education.

Thank you for this opportunity to testify before you today. The Association of Governing Boards would be happy to assist you in any way as you continue your examination of this critical issue. I would be happy to respond now to any questions that you may have.

Chairman PICKLE. Thank you and thank you for your brevity also. If we waited for more data, from whom would we get the data and how long would we have to wait?

Mr. PFISTER. I think it would be possible to make a survey of the members of the AGB. I can't tell you how long that would take, but I think probably within a reasonable period of time more quantitative data would be made available to the committee.

Chairman PICKLE. One of the difficulties we face is this subject has not been reviewed effectively for some 19 years. We have put the American people and particularly associations and universities on notice as of a year ago that we were going to hold these hearings and have been trying to get information.

We have been having difficulty getting information from the various organizations including colleges and universities. They don't seem to want to say any more than they have to say, so it is difficult to get data. We are beginning to get more now, and these hearings have brought some of the data out.

None of us want to act hastily. We want to have sufficient data. I don't know, though, that the committee is going to wait for more data unless we have a time certain to be determined and then to proceed thereafter. So I think we are trying with these hearings to find out if we have enough data now. If we don't, we may take into consideration some additional collection of data, but if we feel we have enough now, I think we ought to go ahead and try to address the issues.

When you say you think the colleges and universities now are getting more entrepreneurial, in what way are they?

Mr. PFISTER. I believe there is pressure nationally to try to accelerate the transition from scientific and basic research into applied research and there are a number of experiments, I think, going on as to how the universities and colleges can accelerate that process I believe this will lead to more entrepreneurial activities by the universities and colleges.

Chairman PICKLE. That is an interesting observation. I thank you, sir.

In the interest of time, we will go on to the next panel but I appreciate your comments and your testimony and thank you for your cooperation.

Now, the Chair will ask for the next panel, No. 5, including Susan Hager, Thom Winkler, Edward Beck, and Geneva Johnson.

Our next panel consists of Susan Hager, who is president of the New York State United Way of America, and Thom Winkler, representing the American Heart Association; Edward Beck, a member of the board of directors of the National Easter Seal Society; and the Family Services of America represented by Geneva Johnson, president and CEO.

We will ask first for Susan Hager to proceed.

STATEMENT OF SUSAN HAGER, PRESIDENT, UNITED WAY OF NEW YORK STATE, ACCOMPANIED BY PAT BARRETT, VICE PRESIDENT FOR GOVERNMENT RELATIONS, UNITED WAY OF AMERICA

Ms. HAGER. Let me clarify that I am president of the United Way of New York State, located in Albany, N.Y. and here representing United Way of America as a member of their task force on this issue.

With me is Pat Barrett from United Way of America, who is vice president for government relations and also associate counsel.

I should also note that although you have invited me as president of New York State, there are several New York State people who would like to be president some day, but none of them have yet invited me to step aside and become a chief professional officer there.

We have submitted written testimony and I would like to make four points today: First, United Way truly values its partnership with small businessmen and women across this country. They provide enormous leadership on our boards and our committees and provide generous support to the campaign. We work together on government relations issues, including board liability insurance and recently in New York State, a new prompt payment law.

We see ourselves as partners with government and business in addressing community problems, certainly not competitors. We, therefore, recognize and respect the concerns of small business regarding UBI.

First, Mr. Chairman, in response to your questions we are concerned over the widespread perception of substantial noncompliance with UBI. United Way of America's members are the 2,300 autonomous local United Ways. They do not pay UBI. Their sources of support include charitable contributions, grants, and in some cases government funds.

With respect to the agencies that we fund, we have begun to look into the extent to which these 37,000 agencies are filing UBI. However, United Way funds are not responsible for any of the activities for which UBI is paid.

We are working to promote understanding and compliance among the agencies we fund by providing local United Ways with a survey instrument and UBI guide. We have strongly encouraged them to obtain data on any income-producing activity of the agencies and to ensure the agencies understanding of UBI requirements. For example, currently the United Way in Baltimore is engaged as part of its annual audit in a review of the UBI filings of its agencies.

To address this committee's concerns with UBI we support and recommend improved data collection, education enforcement, as well as the IRS recommendations. The recommendations from Treasury are appropriate and should be further explored.

We would not support abandoning the relatedness standard or the substitution of a competition standard. This could eliminate legitimate sources of income for long-standing charitable activities.

It could also limit charities to serving only the poor, a contempt of voluntarism that has never been a part of this country's tradition or laws. It could in the end define all competition as unfair competition, and we believe that for-profits and nonprofits both have a role in service delivery.

Third, despite United Way's consistent increases in contributions, for example, last year we raised $2.4 billion, we can't do the job with contributions alone. Agencies must be permitted to use other sources of income.

In 1986, our annual survey of agencies' income found the following sources, 41.2 percent from government partnership, 23.6 percent from charitable contributions, 21.9 percent from fees and dues and 13.3 percent from other sources, which would include grants, an endowment and some sales activities.

We do believe that fees should not be considered commercial activity. Instead this practice is central to our ability to serve the entire community.

We have always had this role, serving the entire community and not just the poor. Our slogan has been, "Thanks to you, it works—for all of us." United Way volunteers face a serious dilemma of meeting too many needs with not enough resources. Some of these emerging needs you certainly know well—day care, illiteracy, AIDS, the alarming increase in poverty among our children, as well as longstanding needs such as family counselling, youth development, transportation for the elderly and handicapped, adoption services and senior citizen centers.

Government has urged nonprofits to do more while at the same time government funds have been cut 36 percent since 1981 in such critical areas as food, clothing, housing and transportation.

In addition, tax incentives have been reduced for charitable giving. One study that we have estimates that charities will lose $11 billion by 1988 when the new tax law is fully implemented. We urge you not to put further obstacles in the path of these agencies.

United Way's partnership with government and business has grown over these our first 100 years of service. We intend to work with you to see that these relationships prosper and grow.

[The statement follows:]

STATEMENT OF THE UNITED WAY OF AMERICA

United Way of America is the national association representing approximately 2,300 independent United Ways located in communities across the country. In 1986 these United Ways raised $2.44 billion for over 37,000 nonprofit human service agencies. United Ways not only raise and allocate these funds, but they also work with these agencies and with community leaders to identify community problems and needs, and find ways to address them. Volunteers from all walks of life, including thousands of small business owners are involved in all United Way decision making and activities.

RECOMMENDATIONS

United Way of America welcomes this opportunity to inform the subcommittee of the activities of nonprofit human service agencies. However, we are disturbed that efforts to clarify the Unrelated Business Income Tax (UBIT) or to respond to the concerns of small business people about competition may be drawn too broadly. If this occurs, it may handicap many services critical to people in our communities.

We are especially concerned that traditional charitable activities may be deemed "commercial" activities because for-profit firms are involved in the same service areas, or the charities in question have legitimate sources of income other than charitable contributions, or they sometimes charge fees for services where it is appropriate. This perspective could impair legitimate and sorely needed charitable activities.

United Way of America has a Task Force on for-profit/nonprofit competition composed of several United Way executives from around the country. It has looked at this issue and specific claims of unfair competition within the human services portion of the non-profit sector. This task force acknowledges that there are some areas of conflict between small business people and nonprofit organizations in the human service sector. These are raising good questions about the difference between nonprofit and for-profit activities. These questions ought to be explored further, but they are also complex questions which need to be examined against the back drop of the problems and needs addressed by the human service portion of the nonprofit sector and how we as a nation intend to fulfill our commitment to meet those needs.

First, in order to facilitate sound discussion on UBIT or "unfair competition" both small business people and nonprofit organizations recognize the need for better data on the nonprofit sector.

We support this need and believe that the best sources are the Internal Revenue Service data that can be derived from Forms 990 and 990T. Previous IRS efforts to aggregate these data were not comprehensive and the information was later withdrawn. However in the interim, some of this information has continued to be circulated and has been misinterpreted to indicate that nonprofit "commercial" activities have soared. We don't believe this is true.

In this testimony we will share with you data that we have collected through the United Way network and the agencies it supports. These data are voluntarily submitted by thousands of agencies across the country.

Second, United Way of America is aware of perceptions that UBIT does not provide a clear framework for determining compliance. We do not believe a totally new framework is needed. Rather, the current framework which tests compliance against the organization's conformance with and fulfillment of its charitable purpose is the proper test of tax exemption and ought to be preserved. Some fine tuning may be necessary, but the framework should stand.

Third, there is a widespread perception that there is a great deal of noncompliance with UBIT. Nobody really knows because data haven't been obtained. There is also a widespread perception that additional enforcement measures may be needed. We believe that UBIT should be enforced and that all nonprofit organizations should comply with the spirit and not just with the letter of the law.

We have taken leadership to promote understanding and compliance. United Way of America has sent to 850 United Ways (those with a staff to work with local agencies) an information kit on for-profit/nonprofit competition, including a manual on UBIT and how to comply with it. Our task force has urged United Way chief professional officers to work with local charitable agencies to increase their awareness and understanding of the law, to actively review agency activities, and to promote compliance where it appears to be indicated.

Furthermore, our task force supports the effectiveness of local dialogue between small business and nonprofit organizations in addressing many concerns between the two groups. We have urged United Ways to consider initiating such dialogues to increase understanding on both sides and to promote constructive and amicable resolution of areas of conflict.

THE BACKDROP FOR AN EXAMINATION OF THESE ISSUES

The need for human services is growing. In the last year or two United Ways have been especially concerned about emerging needs such as the shortage of adequate day care for children of working parents; widespread illiteracy contributing to unemployment, poverty, and isolation; pockets of high unemployment within certain regions of the country, age groups, or minority populations; an increasing inability to obtain health care by groups such as the unemployed or homeless people; an epidemic of drug and alcohol abuse especially among young people; and the dead-end street that teen pregnancy and parenthood represents for many of our young people.

United Ways and the agencies they support seek ways of addressing these growing concerns while at the same time continuing to meet long-standing community needs such as family counseling, youth development and recreation, disaster relief, adoption services, and senior citizen centers. To do this, United Ways often work with the agencies to consolidate services, reshape them and build linkages between existing services and community institutions such as schools, churches, local businesses, and neighborhood groups. This helps to stretch existing resources; but, most often, meeting new needs requires finding new resources.

Because the stresses of modern life have led to many forms of social breakdown and created pressing demands for new service responses, nonprofit human service agencies supplement charitable contributions with other resources. United Ways are closely involved with agency funding needs, often advising agencies on increasing their bases of resources and sometimes helping them to obtain these resources. In addition, through its allocations processes many United Ways gather data about other sources of agency income.

United Way of America conducts an annual allocations survey of United Ways, gathering data on not only United Way funding to agencies, but the agencies' other sources of income as well. This survey represents over $10 billion in agency budgets. Through it, we have found -- on average -- that agencies rely on charitable contributions from United Ways and their own fundraising efforts (23.6%), government grants and contracts (41.2%), fees for service and dues (21.9%), and other revenue-raising activities (13.3%) such as investment income from endowment funds, foundation grants, and sales of goods.

Charitable Contributions

We are deeply disturbed by the assertions of some small business advocates that the only valid source of income for a true charitable activity is charitable contributions. This view is not supported by present reality or by the history and tradition of American voluntarism. Nonprofits have always combined various sources of income and have had a long history of working in partnership with government and of charging fees for services or goods.

If charitable contributions could take care of all our communities' needs, that would be wonderful. Charitable contributions continue to increase and exceed the inflation rate. The American Association of Fund Raising Counsel estimates total contributions to human services in 1986 at $9.13 billion, an increase of 7.4% over 1985. To mark our centennial this year, United Ways have pledged to double overall financial and volunteer resources within the next five years to address more of the pressing problems of the era. But, despite the successful efforts of United Ways, nonprofit agencies, and other groups to raise charitable giving, this source of income alone cannot do the job.

These efforts to increase charitable giving can be hampered by the erosion of tax incentives to make such contributions. The loss of the charitable contributions deduction for nonitemizers, while at the same time increasing the number of nonitemizers, will hurt. The devaluation of the charitable contributions deduction through the reduction of tax rates will hurt. The inclusion of the deduction for charitable gifts of appreciated property in the alternative minimum tax calculation will hurt. While we know that the impulse to give comes from a desire to give something back to the community, we also know that tax incentives encourage people to give more than they ordinarily would.

There are other constraints on charitable giving right now. The trend of corporate downsizing is also squeezing an important supporter of nonprofit organizations -- the middle manager. Corporations are trimming their costs and increasing efficiency by restructuring their organizations to reduce levels of management. Frequently the newly unemployed turn to entrepreneurial activities and establish small businesses for their livelihood. They are often too busy launching and maintaining their businesses to take part in charitable activities. In addition, our work patterns are changing. The number of small businesses (under 250 employees) has increased by 20% from 1978-1984 while large businesses have decreased by 14%. It is more costly and difficult to raise funds from management and employees of 100 small businesses than it is to raise funds from those of one large corporation. As a result of these new work patterns, a greater proportion of funds raised are going to overhead costs.

Government Funds

A primary supplement to charitable contributions is government support. Unlike commercial contracts with government, these funding arrangements represent partnership between government and the voluntary human service sector to jointly address community problems. Government turns to nonprofit agencies to deliver a service for several reasons:

- Nonprofit agencies often have a track record of demonstrated expertise in this field and may even have pioneered this service locally;
- Nonprofit agencies often are asked to help contribute to the cost of providing a service through matching funds or in-kind contributions.
- Nonprofit agencies already exist, with the infrastructure (facilities, equipment, staff) in place to move into a related service arena at less cost than the government setting up its own service.
- Because nonprofit agencies already have service programs available to a broad cross section of the community, the low-income clients served through government funds need not be segregated and can receive the same services as others in the community, avoiding a two-track system -- one for the poor and one for everyone else.

Because of the importance of this partnership to the achievement of public policies intended to provide greatest benefit to the community, government funding has become a substantial part of the support of many nonprofit human service agencies. In the aggregate, the agencies United Ways support receive 41.2% of their income from federal, state and local government. Within individual agencies the proportion of government funding varies widely, ranging from 71% for social planning agencies to less than 1% for cystic fibrosis agencies.

In recent years, however, government funding cuts, particularly of federal funding, have begun to erode this important source of resources to meet critical community needs. According to United Way allocations data, since 1984 government funds have declined in many service areas including:

- Basic needs such as food, clothing, housing, and transportation services.
- Social research and planning.
- Formal and informal education services except special education.

Overall federal funds for human services have been cut by 36% since 1981. United Ways inform us that these government funding cuts translate into cuts in service capacity. United Ways report to us that there is no more room to tighten the belt. Nonprofit human service agencies have to find new sources of income or cut back services and ignore pressing new problems that have presented themselves in their communities.

Fees for Service

To compensate for government funding cuts and to respond to emerging needs, some agencies have placed greater emphasis on fees for service. Charging fees for service is not a new phenomenon. Services such as camping, youth recreation, day care, family counseling, and meals for the elderly have always charged fees, often either a token amount to help defray costs or a sliding fee scale based on ability to pay.

To what extent are nonprofit organizations charging fees or increasing their emphasis on fees? Are increased fees an indication of commercial activities? First, we need to look at the data. Our allocations survey reports on income from fees, but it combines it with dues. Agencies such as the YWCA, Boy Scouts, and Campfire charge dues for general support memberships. These dues help defray the costs of the organization's activities and materials. In 1986 both fees and dues amounted to 21.9% of agency incomes in the aggregate.

United Way of America's best source of more detailed data is our Project Flagship, a computerized effort designed to help communities gather more detailed data on nonprofit human services financing, staffing, and clients served. Through the project, United Ways in 23 communities are working with the agencies they support to obtain detailed data and computerize it in a uniform format so that it can be aggregated to indicate national trends. We are hoping to get many more communities into this process. At this time, we are still working with participating communities to get to the level of detail and uniformity that would permit us to aggregate the data. We are not there yet. What we can share with you for our purposes today are examples of two cities which have achieved a high level of comprehensiveness and accuracy in their data in 1985. These communities -- Seattle, Washington and South Bend, Indiana -- represent two very different size communities and regions of the country and, because of this, give a good snapshot of what may be happening in other communities.

- South Bend: Total income of United Way-supported agencies was $13.8 million. Fees represented only 11.1% of that amount. Looking at individual agencies, income from fees ranged from a low of 1% to a high of 63.8%. Between 1984 and 1985, agencies' income from fees increased 23.6%, the biggest increase of all sources of income. The top increase in income generated by fees (330.3%) was in an Hispanic program which raised $6,024 from this source. At the same time, a few agencies decreased or even dropped their income from fees.

- Seattle: Total agency income reported was $85.5 million. Fees represented 23.7% of that amount. Once again, the proportion of agency budgets that came from fees varied widely from agency to agency, and many charged no fees at all. Here, because Seattle has been in this data-collecting project since its inception in 1982, a four-year time frame is available for looking at fees as a source of income. Between 1982 and 1985 income from fees increased by 33.4%, once again, the biggest increase of all sources of income. These increases also ranged widely from agency to agency from a low of 2.1% to a high of 6,696.7% for a youth service agency which raised $24,604 in operating funds from this source.

Despite the increase in fees in these two communities the agencies are not tilting their services more toward upscale markets that could obtain services in the private market. Human service agencies in these communities continue to serve a predominantly low to moderate income clientele.

- South Bend: Households with annual incomes below $10,000 receive 58.5% of the agencies' services. Another large proportion of services (41%) goes to households with incomes between $10,000 and $20,000. Only .5% of the agencies' services goes to households earning over $20,000.

- Seattle: This community places greater emphasis on the lowest income levels which can be expected of a large urban area. Fully 80.3% of agencies' services go to households earning under $10,000. Households earning between $10,000 and $20,000 receive 16.3% of services, and households earning over $20,000 receive only 3.5% of these services.

However, it is important to note that client income data are not universally available from agencies or from all programs within agencies. Whenever it is inappropriate to ask for income data because there is no fee, or the fee is a token amount, or the question might deter a person from getting help, the agencies may not ask for this information.

In these situations some agencies ask clients to volunteer this information to help them know the types of people they are serving. However, clients may decline to provide this information. Consequently, the data on client income are not comprehensive.

Project Flagship data show that fees are becoming a more important source of income to nonprofit agencies. However, they are not growing in alarming proportions or overtaking other sources of income and distorting the charitable missions of the agencies.

You may wonder why does a charity charge fees? Shouldn't services be free and targeted to the truly needy who have no alternative? Does charging fees transform a charitable activity into a commercial activity?

We disagree. There are many reasons why charities not only ought to be able to charge fees, but should charge them:

- Many needy people would not be served without this system. In many, though not all services, government subsidized programs are available to serve the poor. But these programs do not cover people who are just above the poverty line, or a bit better off but still not able to pay the full cost of services.

  Low paid workers, the elderly on fixed incomes, young families struggling to establish themselves, or families with moderate incomes but catastrophic medical expenses often need services and can get them from nonprofit human service agencies which charge fees that they can afford. If nonprofit organizations were not permitted to serve these people because they aren't poor, they simply would not get help. For-profit organizations are not going to forego their profits to assist all the people who can't pay their rates. If nonprofit organizations are permitted to serve these people but not permitted to charge fees, far fewer of these people would get help. The agencies would not have enough resources to do the job.

- Fees from middle or upper income people able to pay the full cost of services enable nonprofit organizations to subsidize services to those who can't pay the full cost. The amount of the fees above the actual cost of the service would be taken as a profit by a business. In a nonprofit human service agency, either these surpluses are plowed back into service to others or rates are reduced to make services more affordable. This subsidization enables nonprofit organizations to serve many more lower income people than they otherwise could.

- Allowing nonprofit agencies to serve a broad cross section of people is good for the clients. By charging fees, nonprofit agencies are able to serve the widest segment of the community. This prevents the development of a two-track human service system -- one for the poor and one for everyone else. By permitting everyone to get help from the same agencies, more people are encouraged to seek help and to appreciate the value of and need for such care giving in their own lives.

- By serving a broad cross section of the community, nonprofit human service agencies contribute to the overall well-being of the community. United Way's slogans characterize this concept. We have said for years, "Thanks, to you it works, for all of us." Recently we have instituted a new slogan, "United Way, it brings out the best in all of us." The key phrase in both these slogans is "all of us." It is central to the role of charity in fulfilling a public purpose.

  For example, when a nonprofit organization helps a troubled child and his or her family to overcome their problems, the benefits to the community are immeasurable:

  - The community avoids possible costs to the criminal justice or mental health systems if these problems are not resolved and lead to more destructive behavior by family members.

  - The parents' employers will enjoy better productivity once the parents gain assistance with a problem that is distracting them.

- The educational system will be better able to teach without the disruptions caused by a troubled child. The child's classmates will benefit from a calmer environment more conducive to learning.
- The community will gain a productive, responsible adult member when the child grows up with his problems behind him.
- Individuals in the community will suffer less crime and vandalism if the child's problems are resolved before they result in more destructive behavior.

It doesn't matter whether this family is rich or poor. If their problems are not addressed, the rest of the community suffers. In the name of promoting the common good, we encourage the family to seek help by supporting the nonprofit system of human services that can respond with affordable services.

Can these services be provided by the private market? Yes, they can be, and this should be an option to people in choosing a care giver. Should this be the only option? No, if this were the case, some people may forego services believing that the market rates are too high or feeling torn by other demands on their pocketbooks. In other cases, people need the outreach that nonprofit services provide through schools and churches, information and referral services, and public service advertising to persuade them that it's okay to seek help.

Fees for service are becoming a more important part of nonprofit agencies' operations, but they are also closely tied to the agencies' charitable mission to fulfill a public purpose by benefitting the community as a whole as well as assisting the needy.

Other Resources

United Way of America's allocations survey reports that 13.3% of agencies' income comes from other sources. This category is quite varied and includes many items construed as charitable contributions. These other resources are:

- grants from private foundations, or community funds;
- endowment income from the investment of bequests and special gifts donated for specified purposes;
- allocations from other United Ways not the primary United Way in the agency's community (Such funds derive from statewide United Way allocations which are made in a few states and come from United Ways in the state pooling their funds, or from United Way donor designation programs which allow donors to designate their funds to an agency outside their communities.);
- interest income earned on reserve funds (Good management practice advises agencies to maintain some operating funds in reserve to handle contingencies such as delays in payments from funders.);
- sale of goods. (Such income may come from activities either related or unrelated to the agencies' charitable purposes. We don't have a breakout of these items. Some examples of sales of goods related to the agencies' charitable purposes are Girl Scout cookie sales which are designed as an educational experience for young participants. Another example is performance of services or production of goods under contract by sheltered workshops as work experience for handicapped individuals.)

Just as fees in our Project Flagship cities ranged widely from 11.1% in South Bend to 23.7% in Seattle, the proportion of other resources also ranged widely from 18.9% in South Bend to .3% in Seattle.

CONCLUSIONS

The American tradition of voluntarism has fostered a boundless source of energy directed toward curing the ills in our society. At the same time it has improved the quality of life of everyone in all of our communities. Yet this force can be fragile if not cultivated properly. Witness the decline of voluntarism in Western Europe in the second half of this century. Now Western Europe is trying to rebuild its voluntary tradition.

We would urge you in contemplating nonprofit organizations' tax exempt activities to take note of the many ways in which these organizations enrich our lives and what level of support is needed to keep that energy flowing within our communities.

We reiterate the need for more data on nonprofit activities in order to adequately study this area and create better understanding of these operations. We repeat our pledge to do our part to make a conscientious effort to ensure that the law is being adhered to in its spirit. Further, we will continue to encourage dialogue between for-profit and nonprofit sectors to resolve questions at the community level, recognizing the endless spectrum of nuances and local conditions impacting each situation.

Particularly in these days of escalating human needs and our awareness that we must take stronger measures to meet them, the federal government should be making every effort to encourage these activities and not discourage them.

Chairman PICKLE. Let me go now to the next panelist, Mr. Winkler.

STATEMENT OF THOM R. WINKLER, MEMBER, BOARD OF DIRECTORS, AMERICAN HEART ASSOCIATION

Mr. WINKLER. Thank you, Mr. Chairman. I am Thom Winkler, a volunteer member of the American Heart Association board of directors, serving as vice president of Middle Atlantic region.

The mission of the American Heart Association is the reduction of premature death and disability rates related to cardiovascular disease, a disease that remains the leading cause of death in the United States, accounting for nearly 1 million deaths annually.

In recent years, the American Heart Association has made great strides in furthering its mission. Between 1974 and 1984, the age adjusted death rate for cardiovascular disease declined by 27 percent. We believe that such success would not have been possible without the significant financial investments that the American Heart Association has made in terms of providing funds for research and a variety of professional and community educational programs.

Seventy-five percent of all AHA revenues are directed toward these activities. Because we believe that it is important to continue and expand our research and educational efforts, the American Heart Association has embarked on a series of commercial ventures in the form of corporate promotions.

In a promotion, the American Heart Association permits its name and logo to be used in a controlled manner in the promotion of a selected product of a corporation that satisfies the AHA standards or guidelines.

In return, the corporation distributes or broadcasts an AHA approved health educational message to the public providing other benefits to AHA or to the public.

While many of the promotions generate revenue for the association, the primary thrust of such activities is to provide public education. Fund raising alone cannot justify the AHA's participation in a promotional activity with a for-profit corporation.

The AHA has also entered into three licensing arrangements: a cookbook containing heart healthy recipes, a computerized interactive CPR training device and a no-salt, no-sugar herb seasoning.

These products, in addition to being related to the basic AHA mission, had no similar competing products in the marketplace at the time that they were developed by the AHA.

We believe that in addition to providing identifiable health benefits, the American Heart Association's introduction of these products may have spurred the interest of for-profits in manufacturing similar products.

We believe that these corporate promotion and licensing activities are directly related to the mission of the American Heart Association. As a result, we do not pay unrelated business income tax on income earned from these activities.

In recent years we have paid unrelated business income tax on income earned from the sale of advertising space in the American Heart Association scientific journals.

The American Heart Association is concerned with some proposals to limit revenue generating abilities of nonprofit organizations. We believe that the American Heart Association, as well as many other nonprofit organizations provide a plethora of benefits to the public that are often not available from any other sources, governmental or for profit.

It is the American public that will suffer if non-profits are unduly restricted in their ability to generate the revenues necessary to support their exempt purpose.

Mr. Chairman, that completes my testimony.

Thank you.

[The statement of Mr. Winkler follows:]

Statement of the
American Heart Association

The American Heart Association welcomes this opportunity to testify before the House Ways and Means Subcommittee on Oversight on the unrelated business income tax and the federal tax treatment of commercial and other income-producing activities of organizations that have tax exempt status under section 501 of the Internal Revenue Code.

Founded in 1924 by a group of physicians, who were concerned with the lack of information then available regarding cardiovascular disease, the American Heart Association is the nation's largest nonprofit, voluntary health organization committed to the reduction of premature death and disability from heart disease, stroke, and related diseases. More than two million American Heart Association volunteers play a vital role in terms of promoting the mission of our organization. We are an Internal Revenue Code 501(c)(3) entity funded primarily through private contributions.

Cardiovascular disease is the leading cause of death in the United States, accounting for nearly one million deaths annually. This year alone, as many as 1,500,000 Americans will suffer from a heart attack, and of that number, about 550,000 will die. Nearly five million Americans alive today have a medical history of heart attack, angina pectoris (chest pain), or both. Of the current U.S. population of approximately 230 million, over 63 million suffer from some form of heart and blood vessel disease.

In recent years, the American Heart Association has made great strides in reducing death and disability rates related to cardiovascular disease. Though cardiovascular disease remains the nation's number one killer, the age-adjusted death rates for these diseases declined 27 percent from 1974 to 1984.

Such success would not have been possible without the scientific research that has provided a greater understanding as to the causes, treatment, and means of preventing cardiovascular disease. In 1986, the American Heart Association committed $55.2 million for scientific research. That figure represents nearly one-third of our expenses for the year, making the American Heart Association a leader among national health agencies in the support of research.

The translation of research results into information that may be used by the practitioner to treat and prevent cardiovascular disease is another important function performed by the American Heart Association. It is for this reason that the American Heart Association invested $16.1 million in professional education during 1985-1986. In fact, our organization's professional and public education program, which includes the gathering of researchers and scientists at our annual Scientific Sessions for the presentation of abstracts, the publication of nine scientific journals, and the cosponsoring of 12 postgraduate courses, accounts for 27 percent of annual expenditures, exceeded only by expenditures for research.

Communicating all of this acquired knowledge to local communities accounts for nearly 16 percent of the American Heart Association's annual expenditures. In excess of $30 million was spent last year on the nearly 700,000 employees who participated in our Heart At Work program, on the more than 400,000 pre-school and grade school students who participated in Heart Treasure Chest, on the nearly 300,000 teenagers who participated in the Save-a-Sweetheart program, and on the 95 million Americans who shopped at grocery stores participating in the American Heart Association's annual food festival.

It is through these complementary activities of research, professional education, and public education, that the American Heart Association hopes to achieve its goal of reducing premature death and disability caused by cardiovascular disease. Yet, none of this would be possible without the fund-raising activities that provide the financial support for all of our services. In 1986, public support for the American Heart Association raised $151.4 million in revenues -- up 8 percent from 1985. When combined with other sources of revenue, the American Heart Association's total revenue for 1985-1986 was $179.1 million. As the following chart indicates, we have used our revenues effectively and efficiently.

Research	32.2%
Professional and Public Education	27.0%
Community Service	15.8%
Fund Raising	14.7%
Management and General	10.3%
	100.0%

The American Heart Association is proud of its many accomplishments. However, in the current federal budget atmosphere, in which nonprofit organizations are asked to take the place of government services, and in the wake of enactment of federal tax reform legislation, which will discourage a majority of American taxpayers from making charitable contributions, we are concerned with maintaining and expanding funding for American Heart Association programs.

In recent years, the American Heart Association has systematically become involved in relations with corporations that have resulted in significant public education as well as fund-raising opportunities for our organization. We are most pleased to share with the Subcommittee our experiences, which have been based on a cooperative, not a competitive, understanding between our organization and various commercial entities.

I. THE CHANGING NONPROFIT ENVIRONMENT

Throughout our nation's history, government agencies, for-profits, and nonprofit organizations have successfully co-existed. Nonprofit organizations have often supplemented, if not taken the place, of government services in providing for the disparate needs of our nation's citizens. In return, the federal government has provided financial support to programs in which the nonprofit sector has maintained an interest. The government has further sought to encourage American taxpayers to support nonprofit entities by offering a tax deduction for charitable contributions.

In more recent years, however, this environment has significantly changed. While there has been a substantial increase in the number of nonprofit organizations competing for charitable contributions from the public, the federal government's support of programs that are of concern to the nonprofit sector has dwindled. In its 1986 report, The Nonprofit Sector and the New Federal Budget, the Urban Institute projected that during FY 1982 - FY 1986 total federal spending on programs of concern to nonprofits "will fall close to $70 billion below the levels that would have existed had FY 1980 spending levels been maintained. This represents an average reduction of about $14 billion a year below FY 1980 levels." At the same time, the federal government has disallowed major tax incentives that, in the past, encouraged charitable giving.

A. Federal Budget Cuts Have Imposed Additional Burdens on the American Heart Association

The mission of the American Heart Association is the reduction of premature death and disability from heart disease, stroke, and related disorders. In accomplishing this goal, we work closely with federal research, education, and prevention programs, whose goals are similar in nature. Since 1948, the American Heart Association and the National Heart, Lung, and Blood Institute (NHLBI) have been active partners in the battle against cardiovascular disease. Yet, recent cutbacks in federal funding have imposed a greater burden on the American Heart Association with regard to the financing of biomedical research and the implementation of public education programs.

The President's National Institutes of Health (NIH) and NHLBI FY 1988 budget proposals are illustrative of proposed federal cutbacks that have and will continue to affect the American Heart Association. In his FY 1988 budget proposal, the President has proposed only $821.9 million in new budget authority for the NHLBI. This is $108 million below what the Institute received in FY 1987, or an 11.7 percent decrease in funding. Because the Administration has refused to modify its FY 1988 budget request, under the present dollar levels requested, NHLBI will be able to award only 171 new and competing research grants in FY 1988. This must be compared with the 966 new and competing grants that were awarded in FY 1987.

If the Institute is to fund 807 research grants, as proposed in the budget, an additional $116.5 million will be necessary. Furthermore, we believe the average costs of grants included in the Administration's budget proposal have been underestimated. If one assumes a more realistic average cost for grants, an additional $137.2 million will be necessary to fund 807 grants in FY 1988. However, funding 807 new and competing research grants in FY 1988 would still be an unacceptable award level. It would amount to 151 fewer awards than were made in FY 1987.

The American Heart Association has voiced great concern with the President's budget proposals. This is especially so because of the vital information that NHLBI research often yields. This coming year alone, NHLBI has planned: research in human populations to determine the extent to which the results of animal studies of lipoprotein can be applied to humans; identification of the factors involved in the physiology and biochemistry of normal blood pressure regulation in pregnancy; research aimed at identifying the basic mechanisms of the beneficial effect of omega-3 fatty acids on thrombosis and coronary heart disease; a limited clinical study of an implantable, electromechanically powered (tether-free) ventricular assist device for two-year reliability; and a large cooperative research project on the development of atherosclerosis in young adults.

In addition to research, NHLBI has been involved in a number of health education programs. The NHLBI's National High Blood Pressure Program and National Cholesterol Education Program are prime examples of successful public and private cooperative efforts aimed at attacking important public health problems. A new education initiative in blood resources, primarily related to blood donation by the public and utilization by hospitals and physicians, is planned by NHLBI for FY 1988.

Of course, the ability of NHLBI to undertake research and to offer these important education programs is subject to the level of available appropriations. If adequate federal funding is not provided, one of two results will necessarily occur. Either this important research and these important programs will be curtailed, leaving massive gaps in our knowledge as to the causes, prevention, and treatment of cardiovascular disease; or individuals and institutions will turn to other sources for funding.

We believe the latter has been the case in the past and will continue to be so in the future. In their quest to improve the health of the American people, researchers, who have been denied federal funding by a government existing under the restraints of Gramm-Rudman, have turned to organizations like the American Heart Association, in search of research grants. In 1986, the American Heart Association committed $55.2 million for scientists and projects. That represented 32.2 percent of the Association's expenses for the year, making it a leader among national health agencies in the support of research. Similarly, more and more people have turned to the American Heart Association in search of public education programs. In response, our organization invested $30.1 million in 1986 in efforts to educate people at work, school, and where they shop for groceries or dine out.

B. Changes in Federal Tax Law Adversely Impact Nonprofit Organizations

At the same time that the federal government has begun to withdraw its support of vital research and education programs, leaving nonprofit organizations, like the American Heart Association, with the responsibility of providing alternative revenues, the federal government has also curtailed the sources of income upon which nonprofits may depend. Most recently, this has occurred with enactment of tax reform legislation.

At the time of enactment of the Tax Reform Act of 1986, P.L. 99-514, both itemizers and nonitemizers were permitted to deduct 100 percent of any contribution they made to a charitable organization. The deduction for nonitemizers was initially enacted as part of the Economic Recovery and Tax Act of 1981 in an effort to encourage 61 million nonitemizers to increase their contributions to charity. It was scheduled to sunset effective December 31, 1986.

Apparently, Congress was successful in meeting its goal of increased giving. In 1984, nonitemizers contributed $22 billion to nonprofit organizations. That amounted to 36 percent of all money donated by individuals and 30 percent of all donations to charitable organizations by individuals, foundations, and corporations.

However, charitable giving is expected to dramatically decline as the result of enactment of the 1986 tax reform bill, which allowed the charitable contribution deduction for nonitemizers to sunset. According to Harvard University Professor Lawrence Lindsey, the Tax Reform Act of 1986 will result in substantial losses in charitable giving including: $6 billion from expiration of the charitable deduction for nonitemizers; $1 billion from inclusion of gifts of appreciated property in the alternative minimum tax, and $4 billion from lowered marginal tax rates. In total, the nonprofit sector is expected to lose $11 billion.

The loss of this financial base of support may be devastating when viewed in conjunction with the increased financial responsibilities that the federal government has shifted to the nonprofit sector. While ensuring that more individuals will turn to voluntary agencies as the result of diminishing federal support, our government has acted tn discourage individual taxpayers from supporting the nonprofit sector.

It is for these reasons that we have become involved in relations with corporations that have resulted in significant public education and fund-raising opportunities for the American Heart Association.

II. AMERICAN HEART ASSOCIATION CORPORATE RELATIONS

Most of the American Heart Association's commercial ventures have been in the form of corporate promotions, all of which are at the request of and in cooperation with for-profit corporations. In a promotion, the American Heart Association permits its name and logo to be used in a controlled manner in the promotion of a selected product of the corporation that satisfies appropriate American Heart Association standards or guidelines. In return the corporation distributes or broadcasts an American Heart Association approved health education message to the public and provides other designated benefits to the American Heart Association or the public. While many of the promotions generate revenue for the American Heart Association, the primary thrust of such activities is to provide public education. Fund-raising alone cannot justify the American Heart Association's participation in a promotional activity with a for-profit corporation.

The American Heart Association has also entered into three license arrangements with for-profit corporations for the manufacture and sale of American Heart Association products, all of which are mission-related and were developed incidental to the conduct of the American Heart Association's exempt purposes. An American Heart Association cookbook containing heart-healthy recipes is published by David McKay Publishing. A computerized interactive CPR training device is manufactured and sold by Actronics, Inc. A no-salt, no-sugar herb seasoning is blended and sold by InterAmerican Foods. These products, in addition to being mission-related and incidental products, had no similar competing products available in the marketplace at the time they were developed by the American Heart Association. These products provided an identifiable public health benefit. They also may have spurred the interest of for-profits in manufacturing similar products, resulting in an additional benefit for the public. The products are manufactured and sold by for-profit corporations on a for-profit tax base with no benefit from the American Heart Association's nonprofit tax exemption. The American Heart Association will consider licensing or marketing additional "commercial" products if directly related to cardiovascular health or education and if serving the public interest. The American Heart Association will not in any event offer significant numbers of "commercial" products nor otherwise change its fundamental identity as a nonprofit volunteer health agency.

The American Heart Association is considering whether it should become more involved in commercial ventures with for-profit corporations. Significant benefits have accrued to the Association and to the public as a result of the American Heart Association's corporate relations. The American Heart Association's public education messages have been delivered to hundreds of millions of Americans through the mass media. Millions of American Heart Association public education materials have been distributed.

There have been other significant but less obvious benefits. For example, as a result of a dialogue with the American Heart Association, a corporation decided to test market one of its food products with the coconut oil removed. (Coconut is a highly saturated fat, and as such, its consumption should be restricted in efforts to reduce one's risk of cardiovascular disease.) Another corporation has committed to substantial reductions in the sodium content of its products.

Based upon studies, it seems that the public would very positively welcome enhanced relationships between the American Heart Association and for-profit corporations when the purpose is to public education and research. The American Heart Association will not and cannot embark upon these ventures unless in cooperation with and supported by for-profit corporations.

III. THE UNRELATED BUSINESS INCOME TAX

Federal tax law has long recognized that certain organizations should be free from taxation. As early as 1864, certain "literary, scientific and other charitable" entities were not subject to the payment of excise taxes. Legislative history notes, "government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds and by the benefits resulting from the promotion of the general welfare." H. Rep. No. 1860, 75th Cong., 3d Sess. (1938).

Nonetheless, following concerns expressed by the small business community regarding competition by nonprofit entities, Congress, in 1950, enacted the unrelated business income tax. Enactment of this tax, imposed on commercial income earned by nonprofits that is not substantially related to the tax exempt purpose of the organization, was an attempt to place competing nonprofit organizations on the same tax basis as commercial taxpayers. Through the enactment of the Tax Reform Act of 1969, Congress extended the unrelated business income tax to virtually all 501(c)(3) organizations.

In order to be subject to the unrelated business income tax, a nonprofit entity must be engaged in a commercial activity, which meets the following three prong test:

1) The activity must be a trade or business -- involves the production of income from the sale of goods or services;

2) The activity must be regularly carried on -- involves a comparison of the frequency and continuity of the activity as conducted by a nonprofit entity and a commercial entity; and

3) The activity is not substantially related to the exempt purpose of the organization.

Rephrased, a nonprofit organization may operate a trade or a business as a substantial part of its activities, but only if the trade or business is in furtherance of the exempt purpose of the organization and the nonprofit organization was not formed primarily for carrying out the unrelated activity.

(It should be noted that Congress created several statutory exclusions to the unrelated business income tax. In 1969 Congress excepted a series of activities from the unrelated business income tax including: activities in which substantially all the work is done by uncompensated volunteers; activities involving the sale of donated merchandise; and activities conducted primarily for the convenience of members, students, etc.)

Clearly, a major issue in terms of the unrelated business income tax is a determination as to whether or not an activity is substantially related. This requires an examination of the primary purpose of a commercial activity, i.e., it requires an analysis of the relationship between the business activity that generates income and the accomplishment of the exempt purpose.

Unfortunately, the Internal Revenue Code provides no real guidance as to what factors are to be considered in determining relatedness.

IV. CHANGES TO CURRENT UNRELATED BUSINESS INCOME TAX LAW ARE UNNECESSARY

The magnitude of cardiovascular disease is overwhelming, as are many other diseases and issues addressed by nonprofits. Generation of funds is essential to the conduct of the exempt mission of the American Heart Association and other nonprofits. The beneficiary of nonprofit activities is the American public. Frequently, the benefits to the public are available from no other source, governmental or for-profit. It is the American public that suffers if nonprofits are unduly restricted in their ability to generate necessary financial support for their exempt purposes.

It clearly is an undue restriction to penalize or prohibit nonprofits from engaging in revenue generating activities that are substantially related to their exempt purposes. It also seems an undue restriction to flatly prohibit nonprofits from engaging in any revenue generating activities solely because they are not substantially related to the exempt purpose when such activities are not the exclusive nor the major fund-raising activity but, rather, are occasional or incidental. Nonprofits should not be restricted from the ability to adapt to a changing environment, utilize an available opportunity or otherwise be innovative in raising funds. The corollary, however, is that nonprofits should be taxed on income from unrelated activities. If unrelated activities are not the principle or major activity of a nonprofit and if unrelated activities are taxed, there seems no unfairness to for-profits, the government or the public.

The same guidelines should apply to joint ventures between for-profits and nonprofits. There should be no penalty or prohibition against joint ventures when substantially related to the exempt purpose of the nonprofit and when not intended to shelter for-profit activities with the nonprofit's tax exemption. When joint ventures result in unrelated income to the nonprofit, they should be taxed. Again, there seems no unfairness to for-profits, the government or the public.

The American Heart Association accepts that income derived from unrelated business income is and should be taxable, and we do not object to the principles of current unrelated business income tax law. However, neither does the American Heart Association believe that greater limitations and restrictions on nonprofits are necessary or desirable. Where abuses exist, enforcement responsibility rests with the Internal Revenue Service. The American Heart Association does not believe that a rewrite of current unrelated business income tax law is necessary at this time.

V. CONCLUSION

Nonprofits play a vital function in American society. Because their function has not been filled by the for-profit and/or governmental sectors, nonprofits have been granted tax exempt status to facilitate the accomplishment of their exempt purposes. There is no justification to change this fundamental principle. To do so would result in significant losses to the general health and welfare of the American public. If there are abuses, the better course of action is to correct the abuses, not to undertake a rewrite of current unrelated business income tax law.

The American Heart Association maintains that ample justification exists for nonprofit entities to participate in commercial enterprises, so long as the activity is substantially related to the exempt purpose of the nonprofit and was not the primary purpose for which the nonprofit was established. We would oppose any attempts to disallow such activities.

Chairman PICKLE. Now we will ask Mr. Beck if he will proceed.

STATEMENT OF J. EDWARD BECK, JR., MEMBER, BOARD OF DIRECTORS, NATIONAL EASTER SEAL SOCIETY

Mr. BECK. Thank you, Mr. Chairman.

First, I would like to thank you for the opportunity to be here on behalf of Easter Seals.

I have been an Easter Seal volunteer since 1973 serving in various capacities at the local, State and national level. During that period of time I have practiced law, been a county commissioner, worked for the Treasury Department and, at this point, I am a small businessman.

A portion of that business competes with some not-for-profits, so I am fairly well versed about the type of problem the small businessman faces.

Easter Seals is the oldest and largest voluntary agency serving people with disabilities, with over 200 separately incorporated affiliates serving over a million individuals. Annual revenues in fiscal year 1986 exceeded $200 million.

Services are locally developed. There are no mandated services from the national organization. They vary from one locality to another. Programs include services such as physical, occupational and speech language therapies, vocational evaluation and training, camping and recreation, psychological counselling, attendant care and transportation.

Prevention and screening for potentially disabling conditions are always encouraged. Nationwide $80 million or 41 percent of income is contributed through corporations and individuals. Special gifts and bequests are also included in that $80 million. Easter Seals uses many different fund raising techniques, including direct mail, special events, telethon and neighbor fund raising efforts.

Actually, most of those contributed dollars come from small contributors. Other sources of income include 24 percent from government fees and grants. That would include Medicare program grants to support services.

And 19 percent of our income is from program service fees, paid by individuals and insurance companies; 10 percent from sales to the public which includes items produced by sheltered workshops.

And 6 percent comes from other miscellaneous sources, the most important of which is invested income. We haven't had many complaints about competition for most of what we do, but the areas where we do engage in substantial fee-for-service activity and have experienced competition over the last several years is outpatient medical rehab, which includes physical, occupational and speech-language therapies.

Many for-profit businesses have entered this field—particularly motivated by changes in Medicare reimbursement that I have outlined in my written statement.

One important point about Easter Seals is that we do not turn away clients because of inability to pay. We provide services for the poor and, while there are not nationally developed standards, there are locally developed standards for treating people who cannot afford to pay.

Treatment is provided on a fee-for-service basis. It is necessary to accept all clients, not just the poor, in order to maintain a quality of service for all recipients.

In the area where I come from, which is rural Pennsylvania, we are the major provider of outpatient physical and speech therapy services.

We do cover our expenses with physical therapy, but to the extent that we have any excess expenses and contributions, they cover many programs that don't produce any income at all.

I would point out, although we don't collect this information specifically, the National Easter Seal Society has had an audit on unrelated business income within the last year-and-a-half, and there was no adjustment for unrelated business income. In fact, as far back as we have records, the National Easter Seal Society—this is separate from the affiliated organizations for which we just don't have all the information—has only had $56,000 in unrelated business income and it wasn't for any particular type of activity.

Thank you very much.

[The statement of Mr. Beck follows:]

Statement of J. Edward Beck, Jr., Member, Board of Directors, National Easter Seal Society

Dear Mr. Chairman:

This statement is submitted on behalf of the National Easter Seal Society in connection with the hearings that you are holding to review the unrelated business income tax. We appreciate the opportunity to express our views in this public forum and hope that the information that we provide the Subcommittee will be helpful in its examination of the issue.

Our organization does not compile data relative to the applicability of the unrelated business income tax to the activities of our affiliates. However, based on the information that we do have, it appears that the current regulatory scheme is workable. It seems adequate for the task of resolving any difficulties that may exist between for-profit businesses and tax-exempt organizations.

We believe that an overview of the programs and revenue sources of Easter Seal Societies will be useful to you in your deliberations. This profile addresses many of the points raised in the Committee on Ways and Means Press Release dated September 12, 1986 which outlined the scope of the Subcommittee's review. It is based on the operating statistics of our organization which are included in our annual report and available to the public upon request.

The National Easter Seal Society is the world's oldest and largest voluntary agency providing direct services to people with disabilities. Founded in 1919, our organization has become one of the country's most effective human service institutions. More than one million people a year benefit from quality-assured services available in every state, the District of Columbia and Puerto Rico.

The Easter Seal Society is a nationwide network of separately incorporated affiliates that is united in the common mission of promoting the maximum independence of persons with disabilities. Approximately 200 state and local Societies operate more than 400 program service sites across the country.

The National Society, headquartered in Chicago, is a separate corporation that provides assistance to the network of affiliates. Generally, there are no mandates from the national headquarters relative to the programs of local Societies. Services provided by local Societies are tailored to meet specific community needs. This policy gives local affiliates a great deal of flexibility in developing programs and enables them to be responsive to a changing environment.

As community needs are identified, Easter Seals is there to assist persons with disabilities and their families in making effective use of resources that will help them develop their abilities and live purposeful lives. Although no specific services are mandated, Easter Seal programs must meet nationally-recognized, independent accreditation requirements and performance standards to assure quality care and efficient operations.

Our organization often provides services financed with contributed dollars which would not otherwise be available to persons in need. Our flexibility and resourcefulness enable us to address problems that the government, for one reason or another, is unable to solve.

Services provided by local Societies often vary from one area to the next. Services provided by our affiliates include: physical, occupational and speech-language therapies, vocational evaluation and training, camping and recreation, psychological counseling, attendant care and transportation. Prevention of, and screening for, potential disabling conditions are also encouraged and sponsored by Easter Seals.

Individuals of all ages with disabilities resulting from any cause can find assistance through our programs. We provide services to a broad cross-section of people including the two-year-old child with cerebral palsy, the thirty-year-old worker with a brain injury, and the senior citizen who has had a stroke.

The contribution of volunteers in our organization is extremely important. An estimated 800,000 volunteers give their time, talent and resources to the people served by our agency.

Our fundraising sources are just as diverse as our programs. On a nationwide basis, we raise about $80 million through contributions from individuals and corporations, special gifts and bequests. That constitutes about 41 percent of aggregate nationwide income. We utilize many different types of fundraising techniques including direct mail, special events, telethon and neighbor-to-neighbor efforts. In all of our fundraising, the Society fosters a grass roots approach that enables affiliates to retain more than 90 percent of all revenues in the area where it is raised to support services in local communities.

Unfortunately, we are struggling to maintain our base of contributed income. There is more competition for the contributed dollar today than there was just a few years ago. The media continues to raise our consciousness about severe human problems such as world hunger and the plight of the homeless resulting in new initiatives to raise donations. These worthy new causes are presenting additional options for the American donor and making it more difficult for older, more establisned charities to maintain their funding base.

The changes in tax policy made by the Congress last year are expected to exacerbate an already difficult situation for the nation's charities and the indigent people that we serve. The elimination of the tax deduction for nonitemizers and the reduction in tax rates will lessen the incentive for the American public to give to charitable institutions like Easter Seals.

Furthermore, the government has reduced funding for social programs. This has driven many social agencies, heretofore heavily dependent on government funds, into the hunt for the contributed dollar. The reduction in government programs has also increased the demand on Easter Seals and other voluntary organizations for services.

The flow of contributions is critical if Easter Seals is to continue to provide services to those unable to pay. As the government becomes less willing or able to meet the needs of its people, voluntary organizations must do more. Easter Seal staff and volunteers across the country are asking themselves the same question: Where will we get the funds to not only maintain existing programs but to meet the increasing demands present in a changing environment?

Other sources of income are equally tenuous. We currently receive about $46.6 million a year, or 24 percent of total income from government grants and fees. In many areas, we provide rehabilitation services to Medicare and Medicaid beneficiaries. Some of our affiliates receive fees from government agencies for clients who are being trained for competitive employment under the state grant vocational rehabilitation program. Other funding sources include Title XX, Early Childhood Education Grants, the Maternal and Child Health Block Grant, and programs authorized under the Jobs Training Partnership Act and the Developmental Disabilities Act.

With respect to government grants and fee income, the best that Easter Seals can hope for is maintenance of the status quo. Public officials at all levels of government have made it clear that public financing of human services has reached a plateau that is likely to continue for the foreseeable future. Some have even suggested that the severe cuts in social programs made in recent years have not been enough.

Another major component of our funding scheme is program service fees, which constitute about 19 percent of our total income. These fees consist of the medical services that we provide to children with disabilities in the public schools. In many communities, we contract with the public school system to provide services to children as required by the Education for All Handicapped Children Act (P.L. 94-142). In some cases, our outpatient rehabilitation centers receive fees from other third-party payers (i.e., insurance companies) for services such as physical, occupational and speech-language therapies.

Nongovernment service fees also include those paid by individuals with adequate financial resources. Charging a fee for service is not inimical to the Easter Seal mission. Individual fees subsidize services to those who cannot afford to pay. Small community-based agencies like Easter Seals often cannot maintain adequate staff to serve only poor people. In some cases, Easter Seal affiliates need to serve a variety of clients with varying financial resources to maintain programs. Furthermore, in some areas, the Easter Seal Society is the only health care provider of certain services and, therefore, inevitably serves individuals from a variety of socioeconomic groups.

Sales to the public and "other" revenue constitute the remaining 10 percent and 6 percent respectively of the combined nationwide income of all Easter Seal affiliates. Most of our sales income is derived from products made or assembled by persons with disabilities in our work centers who are being trained for competitive employment. These centers have vocational training components which rely on contract work with businesses, state government, or the federal government through the Javits-Wagner-O'Day program. Some Societies sell craft items which are made by individuals participating in our homebound programs. These programs enable persons with disabilities to work in their homes producing items that can be sold through local Societies. A small portion of sales income consists of revenue from the sale of medical devices and rehabilitation-related equipment sold to individuals who clearly have the ability to pay. There is also some revenue from small items sold in connection with fundraising events.

The "other" income referred to consists primarily of investment income on reserves and revenue from various sources such as restricted endowment funds. These accounts enable Societies to maintain their operations on a fiscally sound basis.

It is difficult to determine to what extent the activities of our affiliates compete directly with for-profit businesses. It does not appear to be an issue in most of the communities where we provide services. However, there has been some competition in recent years in the area of outpatient medical rehabilitation.

For years, many Easter Seal Societies have operated freestanding outpatient medical rehabilitation facilities which provide physical, occupational and speech-language therapies and related services to individuals with disabilities. Until recently, this area was essentially the province of tax-exempt organizations. But that is changing as more for-profit businesses are getting involved in outpatient medical rehabilitation. Changes in Medicare reimbursement policy have largely precipitated this change.

In late 1980, Congress significantly expanded Medicare reimbursement for rehabilitation services provided in freestanding centers. At that time, legislation was enacted establishing Comprehensive Outpatient Rehabilitation Facilities (CORFs) as providers under Part B of Medicare. This statutory change was made in the Reconciliation Act of 1980. Under the Act, all of the services provided by CORFs are reimbursable. The CORF provision was implemented in late 1982 and, to date, over 100 facilities have qualified under the amendment.

Not long after Congress enacted the CORF provision, there was a major change in Medicare policy by the passage of the Prospective Payment System (PPS) for hospital reimbursement. Under PPS, hospitals are reimbursed under a pre-established fee schedule based on a patient's diagnosis. This encourages hospitals to discharge patients more quickly than they had been doing in the past. The result is an increase in the number of Medicare patients receiving services on an outpatient basis. The demand for outpatient rehabilitation services has clearly expanded. This development along with the passage of the CORF legislation has encouraged physicians and other entrepreneurs to develop community-based facilities which provide services to Medicare beneficiaries.

The entree of entrepreneurs into outpatient medical rehabilitation is bringing Easter Seal Societies in some communities into head-to-head competition with businesses. The financial and human resources and marketing prowess of these for-profits sometimes undermine the viability of Easter Seal programs. In some areas, our affiliates are evaluating whether or not to maintain these programs. Among the factors an Easter Seal affiliate must consider is whether or not the community can be adequately served if the Society discontinues its efforts in medical rehabilitation.

The Subcommittee is well aware that many Medicare beneficiaries have limited resources. Easter Seal affiliates which serve these individuals often supplement reimbursable services such as physical therapy with services such as attendant care and transportation which are not covered under the Medicare program. These services are financed with contributed dollars. For example, some Medicare beneficiaries who need rehabilitation do not have access to these services because they do not have the transportation to and from the health care provider. Elderly persons who are not ambulatory need special transportation in order to access health care services. In many instances, an Easter Seal agency or other nonprofit human service agency provides transportation. If these providers withdraw from the Medicare program, many beneficiaries may not get the services that they need. From this perspective, it seems clear that the objective of the Medicare program (that eligible senior citizens and persons with disabilities receive adequate medical care) is well-served by the continued existence of the small nonprofit provider like Easter Seals in outpatient medical rehabilitation.

Some competition between the activities of our organization and for-profit businesses is inevitable. In outpatient medical rehabilitation, entrepreneurs are increasingly providing health care services that have traditionally been delivered by tax-exempt organizations. Tax-exempt organizations, on the other hand, are becoming more innovative and, hopefully, more efficient and effective in their work. In some quarters, this may be threatening to the for-profit sector.

In our organization, our volunteers, many of whom are leaders in the business community, are promoting growth and innovation in both the delivery of services and the fundraising activities necessary to finance those services. All of these new activities are developed within the context of our tax-exempt purpose. We are driven by our goal of serving the maximum number of people in the most efficient and effective way.

We are clearly interested in growth because we are acutely aware of the major gaps in our national human service network. Persons with disabilities of all ages are not getting the health care that they need to become more independent. The need for adequate employment training and educational opportunities is not being met. Our public transportation systems, in most cases, are not accessible. Furthermore, there is not adequate housing, which is an important prerequisite to obtaining employment, living independently and avoiding costly institutionalization. Because government has been unwilling or unable to meet the demand for these services, it is extremely important that the voluntary sector is unimpeded in its effort to meet these human needs.

We believe that voluntary organizations like Easter Seals are more flexible and responsive to human service concerns than the government can often be. With less bureaucracy and fewer political constraints, we are able to retreat from one area of service and move into another, as dictated by changing community needs.

The activities of voluntary organizations should be encouraged, not discouraged, by the federal government. Congress should use extreme caution in developing any revisions to the unrelated business income tax to ensure that the nonprofit sector is able to continue its efforts to meet the growing demand for human services.

Respectfully Submitted,
THE NATIONAL EASTER SEAL SOCIETY

Chairman PICKLE. We appreciate your statement.

Next will be Geneva Johnson, president of the Family Services of America.

STATEMENT OF GENEVA B. JOHNSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FAMILY SERVICE AMERICA, ACCOMPANIED BY PATRICIA A. LANGLEY, DIRECTOR OF GOVERNMENT AFFAIRS

Ms. JOHNSON. Thank you, Mr. Chairman.

My name is Geneva Johnson and I am president and chief executive officer of Family Service America.

Pat Langley accompanies me, our director of governmental affairs here in our Washington office.

We are an organization of some 290 member agencies and we are celebrating our 76th year. Our interest in testifying at these hearings on the unrelated business income tax results from a desire to assist the Congress in understanding the operation and purpose of community not-for-profit agencies.

Our agencies provide a wide range of services, including counseling, marital and family therapy, alcohol and substance abuse, family violence, services to the elderly, to teen parents and to abused and neglected children.

Family Service America collects annual detailed information from our member agencies on a variety of matters. Among the data collected is information on sources of income. I would like to share some of that data with you.

In 1985, the total income for our 290 member agencies was over $257,885,836. Of that total, 36.4 percent was income from local United Ways or sectarian agencies, such as the Jewish Federation or Catholic charities.

Government sources provided another 35.7 percent of the total. Fee-for-service income from clients who could afford to pay all or some of the cost of their services amounted to only 8.3 percent.

The remaining 20 percent came from a variety of sources including investment, contributions from individuals and business, foundations, income from special events and bequests.

Out of our entire membership, three agencies filed a form 990–T in 1985.

One agency from the Southeastern United States with an annual budget of about $800,000 owns property and rents space in that property. No taxes were due in 1985.

A second agency in the Western region with an annual budget of $1 million operates a small cafe that seats about 75 people, staffed mostly by volunteers to raise money that is used in the agency's program for families in that local community.

The IRS advised this agency that since the paid agency staff assisted in the operation of the cafe, a form 990T should be filed. Accordingly, the agency paid $245 for the operation in an unrelated business tax in 1985.

A third agency in the Midwest with an annual budget of under $1 million has a "related corporation" that is designated 501(c)(2), which is a property holding company for some land donated to the agency.

In 1986, that agency paid $2,000 in unrelated business income tax. The information given above reflects the amount of information available to Family Service America from its surveys of the agencies.

Today I would also like to address the matter of fee-for-service income in a not-for-profit agency. Fee-for-service income is that amount paid by some families to our agencies for services on a sliding scale basis. Many families pay nothing but still receive the same quality of service as any other family. Almost all pay less than the cost of the service to the agency.

It is our position that such income is an appropriate resource for Family Service agencies and should remain untaxed as long as the agency is fulfilling its community purpose and is serving all strata of families in the community.

In other words, we consider such an activity as appropriate within the relatedness standard of the unrelated business income tax and believe it would be detrimental to communities if changed.

Agency income from this source, though small, is important and is used to subsidize services to families who pay no fee.

For example, in our Seattle agency in 1983 there were 1,002 people below the income of $15,000 served by the agency. By 1986, there were 1,593 persons below income of $15,000, an increase of 63 percent of people below the income of $15,000 were served as a direct result of the fees that were charged to the agency.

Another matter that I wish to address is that of accountability. In testimony given before this committee on Monday morning, the official from the Treasury Department made an observation about absence of accountability of not-for-profit organizations and compared them unfavorably to businesses who are accountable to their stockholders.

Family Service agencies, like most accredited, community, voluntary organizations, are accountable to the community through the governance of their voluntary boards comprised of community leaders and representatives.

Volunteer boards determine the program focus and expenditures of Family Service agencies based on the broader needs of the community and existing gaps in service. Family Service agency accountability is also strengthened by the requirements imposed on them by our organization for accreditation.

Every Family Service agency in our membership must meet the stringent requirements of the National Council on Accreditation. Reaccreditation every four years is required. The result is an appropriate adherence to mission and quality service delivery. In addition, our agencies must also adhere to strict accountability standards set by their local United Way.

We believe there is much benefit and accountability to the community and the nation from this kind of citizen leadership found uniquely in not-for-profit organizations. In addition, not-for-profit community organizations provide the long-term community infrastructure and continuity from generation to generation as exemplified by the Family Service agency, the YMCA, the YWCA, Catholic Charities and so forth.

A delicate balance exists in our society among the three sectors—government, business and the independent sector. Through the protections of tax policy, government assures the vitality of both the nonprofit and the for-profit sectors and allows each to play an indispensible role in a free society.

The unrelated business income tax expresses the clear intent of Congress and communicates its wishes that not-for-profit organizations adhere to their community purpose and pay taxes on any activity that is unrelated to mission.

Efforts to design a more restricting governance for not-for-profit agencies would in my opinion risk major disruption in the sector and might hurt the innocent as much, or more than any offenders.

In testimony heard earlier this week, the Treasury Department urged that the subcommittee examine and study seven areas where the law poses problems. We especially support the need for obtaining adequate and clear data on the activities of not-for-profit organizations.

With regard to the relatedness standard, this is a concept that goes to the heart of the operation of the community agency in our society.

We believe that the current unrelated business income tax design works well in this area for Family Service agencies and the communities we serve.

The other recommendations of the Treasury Department for study do not touch on the operation of Family Service agencies. Therefore, I shall not address them.

We thank the committee and its staff for the time and work that have been devoted to this important task.

Thank you.

[The statement of Ms. Johnson follows:]

TESTIMONY OF

GENEVA B. JOHNSON
PRESIDENT AND CHIEF EXECUTIVE OFFICER

FAMILY SERVICE AMERICA

My name is Geneva Johnson. I am President of Family Service America. It is my pleasure to represent this organization today. I want to thank the subcommittee for this opportunity to share our views concerning appropriate charitable activity in this society and the present tax treatment of that activity. Our interest in testifying at these hearings results from a concern that a growing misunderstanding seems to be forming in both Washington and state capitols with regard to the nature of appropriate charitable activity in this society. FSA can speak, of course, only for the type of charitable activity that involves family service agencies and their relationships with the communities they serve.

Family Service America is 76 years old. It represents 290 organizations throughout the United States and Canada whose primary focus is on strengthening family life. It is a citizen-led movement, with over 10,000 volunteers working in their local communities to keep Family Service the important force for community betterment that it is. Most Americans have ready access to a Family Service agency. They can be assured of a professional staff working within an organization which is rigorously self-monitored through a detailed accreditation system. Services available range from general family and marriage counseling and family life education to such specific programs as those directed to single parents, violent families, substance abuse or services to industry, for example.

Family service agencies receive most of their income from three sources: United Way campaigns (36.4%), government sources (35.7%) and fee for service income (8.3%)*. The remaining 20% comes from endowments, individual fund raisers, membership, etc.

United Way income is utilized by agencies for operation expenses including specific program costs. Government resources provide for the costs of mostly categorically directed programs such as child abuse, child care, family violence, etc. The fee for service income is paid on a sliding fee scale by families able to afford a portion of the service provided to them.

Since 1980, family service agencies, like most community nonprofit organizations, have witnessed a decline in income from government programs as well as United Way sources due largely to changes in government policy and an increase in the numbers of individuals needing help. Fee for service income becomes especially important at a time when funding sources are declining. As indicated earlier, FSA agencies received 8.3% of their total income in 1985 from fee for services. In 1984, that amount had been 7% of total income. For decades, it has been the practice of most family service agencies to charge sliding scale fees for services provided to families able to pay. We expect this source of income to increase in small annual increments and to be utilized by agencies to provide more services in the communities they serve. It is our position that a reasonable percentage of fee for service income is an appropriate source of income for family service agencies and should remain untaxed as long as the agency is fulfilling its community purpose and is serving all strata of families in that community.

As indicated above, family service agencies provide a complex array of services depending on the needs of a given community. These services are designed apart from considerations about family income and concentrate instead on responding to community problems wherever they are found. In other words, our services are not restricted to the poor. Volunteer community boards of family service agencies determine what services are needed. Such judgements are based on assessments of overall community needs and may address gaps in services for certain ethnic groups, or a need for more protective services for families experiencing violent or destructive behavior, or a program for pregnant teens, or a lack of adequate child care for low-income families, etc. Agencies often design specific programs to help the community with an emerging problem -- it might be a program for children from divorced families, or a program for newly unemployed parents, or self-help groups for women caring for elderly parents, etc.

---

* These percentages relate to total membership income in 1985.

Staff and volunteer boards in family service agencies often identify serious and complex problems as they emerge and respond by stimulating a variety of community resources to meet the problem. I would like to give a concrete example of how the family service agency responds to a community crisis. About a decade ago, increases in reported incidents of family violence became a paramount concern in many communities across the nation. The volunteer boards of family service agencies throughout the country responded by establishing programs to help communities meet the challenges associated with family violence. Family service agencies began to provide staff to train police department personnel; they accompanied police officers to homes where violence was occurring; they provided on-site counseling and support to diffuse volatile situations; they established counseling groups for abusers; sat on boards to establish new nonprofit shelters for abused women and their children; established hot lines, and lobbied Congress and state legislatures for more funding for shelters and protective services for family members. And, of course, they provided counseling for families in need of rehabilitation so that the cycle of violence might be stopped. If one ponders such service to a community, it becomes apparent that an agency cannot restrict its focus to providing services to one strata of society. Instead, the family service agency responds to social problems that disrupt families and the larger community. Most often, such work by community nonprofit agencies occurs in a vacuum where no other structures are available to meet the crisis. Today, violence in families continues to be a problem in communities across the nation and family service agencies continue to play a major role in the network of services so important to those families.

FSA is concerned about proposals that might be introduced in the Congress that would restrict those who can be served by nonprofit agencies to the very poor. Such a change in laws governing tax-exempt organizations would dramatically alter the function of the community nonprofit agency. Family service agencies and other nonprofit community structures have evolved in our geographically and ethnically diverse nation to allow for multiple responses to community problem solving. Those who are served by our member agencies are not branded as poor when they receive those services although they may pay no portion of the service costs. Others may pay a little and still others may pay more if they have sufficient family income. Almost all pay less than the cost of the service. Those who do pay on a sliding fee scale make it possible for the services provided to the community to reach as many people as possible without regard for financial status. It is well understood that government welfare programs stigmatize the families who participate in the programs. Such restrictions on the nonprofit community agency would be destructive to poor families and would deprive the larger community of a vital and efficient mechanism for problem solving based on the initiative of private citizens.

We know that neither government nor business fosters this kind of citizen leadership apart from any personal profit or employment. Nor do they offer the long-term community infrastructure and continuity from generation to generation that are afforded by the family service agency, the YMCA, the YWCA, the Girl Scouts, etc. No matter what trends come and go in commerce or government policy priorities, these agencies remain as reliable, accredited, accountable, citizen-led entities.

It is important to recognize the way the three sectors of our society operate in this diverse land. Each sector -- government, business, and the independent sector -- play different and vital roles in our society. Government provides the overall direction for our society and watchdogs for excess developments that would be harmful to society and its institutions. Excessive government would be destructive in a free society. Excessive free enterprise can be harmful to larger community interests. Excessive activities by nonprofit organizations -- which cross traditional boundaries -- could be disruptive to the operation of the marketplace. A very delicate balance is involved. Through tax policy, government assures the vitality of both the nonprofit and forprofit sectors and allows each to play an indispensable role in our free society.

We would hope that the Congress realizes that too little is really understood about the activities of the independent sector and the way it contributes to a free society. This lack of information does not make the independent sector any less vital to the total system. The Unrelated Business Income Tax (UBIT) expresses the clear intent of Congress and communicates its wishes that a nonprofit organization adhere to its community purpose and pay taxes on any activity that is unrelated to its missions. Efforts to design a more constricting governance for nonprofits would, in my opinion, risk major disruptions in the sector and might hurt the innocent as much or more than any offenders. We have urged our member agencies to be fully cognizant of the rules concerning UBIT and to be sure that they do not stray from their community purpose. Our membership requirements also demand that their services be structured to serve all strata of families in the community. It seems desirable for the Internal Revenue Service to have the necessary resources to conduct audits and provide scrutiny to assure compliance with the UBIT.

Finally, there is also the matter of definition of a charitable organization under section 501(c)(3) of the tax code. The traditional understanding of this portion of the code supports the concept that charity embraces a wide and changing variety of purposes and methods, and extends far beyond the category of gifts for the relief of poverty. We believe that our member agencies -- and hundreds of other nonprofits -- operating under that guidance from the code, have made significant contributions to their communities for many generations and that this definition of charitable activity does not limit services from a nonprofit organization to one strata of society.

Until such a time as the necessary research is conducted and resultant data becomes available, we believe that either major revision of the UBIT -- such as significantly changing the definition of what is deemed to be related activity -- or changing the definition governing appropriate charitable activity would be most unfortunate.

Thank you for giving us this opportunity to testify here today.

Chairman PICKLE. I thank you very much. Let me ask the panel as a group, are any of you engaged in unrelated activities that you are actually paying UBIT taxes on today? I understand as you have just testified, Ms. Johnson, that there are two or four agencies you have mentioned. With your exceptions, and I will come back to you. I assume the other groups are not paying UBIT. Although one of you said you paid UBIT on a real estate transaction a year ago, but you don't generally now, is that correct?

All right.

Are any of you participating in any joint venture or partnership with a for-profit enterprise?

None of you are in any joint ventures?

Let me go into some of the specific categories that we have heard mentioned in testimony. Mr. Winkler, you testified that you do put out some books, cookbooks?

Mr. WINKLER. Yes, sir.

Chairman PICKLE. And there is a shortage of this type of information that is available so that you publish it.

Suppose if there were for-profit businesses that were to offer virtually the same service and gave out the same information that you want or you recommend regarding CPR training and herb seasoning or all these things, would you cease your operations?

Mr. WINKLER. Well, Mr. Chairman, if——

Chairman PICKLE. A for-profit group offered your same business line, would you go out of business?

Mr. WINKLER. Mr. Chairman, we initiated these items that we licensed such as the cook book, the computerized CPR training device and no salt, no sugar herb seasoning prior to any introduction of those items by for-profit organizations. The American Heart Association is currently reviewing its position with regard to its relationship with for-profit organizations and so it was——

Chairman PICKLE. I take it you would not intend to go out of business because you were in the business first?

Mr. WINKLER. Well, as I say——

Chairman PICKLE. I want to establish——

Mr. WINKLER. We are reviewing the materials now, Mr. Chairman, and it may be at some point in time we would phase out participation in a licensing agreement but——

Chairman PICKLE. Let me ask you, Mr. Beck, are any of your local operators actually selling hearing aids?

Mr. BECK. Yes, there are. As far as we know there are three affiliated Easter Seal units that are selling hearing aids. One is the Capital area Easter Seal Rehabilitation Center in Austin, Tex.; another is the Easter Seal unit part of a State unit in Sioux City, Iowa; and the third is the Northern Rocky Mountain Easter Seal Society located in Montana.

Chairman PICKLE. Are you selling those hearing aids cheaper than for-profit business sells them?

Mr. BECK. Well, our people from Northern Rocky Mountain tell me that they are in the mid price range in the manner they are selling them.

The people in Austin tell me that they are perhaps cheaper than others and one of the reasons is because they are providing hearing aids as an integral part of speech, language, and audiology services, and are providing them principally for the poor. In fact revenues from hearing aids in Capital Area Easter Seals was $8,000 during fiscal year 1986 out of a total budget of $1.5 million. Hearing aids were made available for those poor that wished to purchase them at $5 a month and for sales of up to $450 to $500 a unit; and for those who couldn't afford them even at $5 a month, they were made available on a permanent loan basis.

Chairman PICKLE. Do any of your local operators now actually receive grant money as well as tax exemption?

Mr. BECK. Grant funds?

Chairman PICKLE. Yes.

Mr. BECK. Yes. As a matter of fact I would estimate—because we collect information in a slightly different way on government fees and grants—some of the goverment income would come from Medicare as fee for service. But about 12 percent would actually come from government grants of various types.

Chairman PICKLE. About 12 percent.

Mr. BECK. About 12 percent from grants, excluding fees from Medicare and Medicaid.

Chairman PICKLE. Ms. Hager, you stated that as you proceeded to give services in the United Way you found you needed to get more income.

Ms. HAGER. Yes, sir.

Chairman PICKLE. Because of certain reasons. And in order to get more income you have gone to fees for services. I am wondering, I think you said about 13.3 percent of your income comes from other services?

Ms. HAGER. Other sources, that is correct.

Chairman PICKLE. Is this what you call noncontribution income? What are the other sources?

Ms. HAGER. This would include grants, it would include endowment income as well as income from sales. It is a mixed category.

Chairman PICKLE. In all these categories, are they paying UBIT?

Ms. HAGER. They would not be paying UBIT on grants and endowment income but from sales, yes.

Chairman PICKLE. Would they pay UBIT on other sales?

Ms. HAGER. If the sale is a result of an unrelated for-profit activity, yes they would.

Chairman PICKLE. Earlier you said your groups did not pay UBIT.

Ms. HAGER. We are talking about two different groups.

Chairman PICKLE. I beg your pardon.

Ms. HAGER. What I said was that 2,300 United Ways in this country do not pay UBIT. The survey in our testimony relates to the 37,000 agencies that United Ways' fund. The sources of income: 41.2 percent from government, 13.3 percent from other sources related to total income for the 37,000 agencies.

Chairman PICKLE. Did your group pay UBIT on the 13.3 percent from the other sources of income?

Ms. HAGER. We do not yet have complete data on the amount of UBIT that our agencies are paying.

Chairman PICKLE. Why wouldn't you know? Why wouldn't you have that data?

Ms. HAGER. We would like to have that data and we have commenced a project as I said in my testimony, we have provided United Ways with survey instruments and instructions as to how they would begin to collect that.

Chairman PICKLE. Your instruction to your local operators are now out?

Ms. HAGER. That is correct.

Chairman PICKLE. When did you give your instructors that, why haven't you gotten——

Ms. HAGER. I believe we just gave it to them this winter. The task force formed by United Way of America met throughout the fall of 1986 and worked very hard and has this past winter/early spring provided that information to the local United Ways.

Chairman PICKLE. In that same connection you stated, Ms. Johnson, that you had a survey and you had a total of about 8.3 percent of your income from fee for services. As Ms. Hager has just stated, relate that to me in terms of dollars. What is 8.3 percent of your total income, what is that in dollars roughly?

Ms. JOHNSON. The total income is $258,885,000, is it would be——

Chairman PICKLE. $258 million and 8.3 percent is fees for services.

Ms. JOHNSON. Right.

Chairman PICKLE. Now, is that amount subject to UBIT?

Ms. JOHNSON. No, because the fees for service are for services that relate to our role in mission. They are for counseling services.

Chairman PICKLE. How much of that amount is related to UBIT? How much of it is actually subject to the UBIT?

Ms. JOHNSON. I would say none because it's fees for service related to our role in mission. It is fees for service for counseling services.

Chairman PICKLE. 8.3 percent of your other income is not subject to UBIT?

Ms. JOHNSON. No. No. It is——

Chairman PICKLE. What is subject to UBIT? You gave me three instances.

Ms. JOHNSON. What would be subject to UBIT is what I mentioned earlier. We have three agencies, one was related to their renting space and receiving income from renting that space; the second one—these are the only three that came up in our survey—the second was for operating a cafe that was staffed mostly by volunteers and the agency was taxed on that portion that they had paid employees to do that; the third was for an agency that had a holding company and had received some donated lands and were paying taxes on that.

But the 8.3 percent for fees comes from people who pay on a sliding fee scale basis for a service. As I mentioned later in an example of an agency, they were able to increase services to those who could not pay by 63 percent using the fees for service to pay for those.

Chairman PICKLE. Do we have on record from you the amount of UBIT you did pay the last year or two?

Ms. JOHNSON. Yes.

Chairman PICKLE. And for what categories have you paid it?

Ms. JOHNSON. Yes.

Chairman PICKLE. We will be glad to review that then.

Thank you very much.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. I would like to thank the panel for their very interesting presentation. I have only one question and it is a slight tangent. The question is, Do you have passive income and do you think that passive income should be treated any differently? I would like to ask each of you to respond to that if you will.

Mr. WINKLER. I understand that we would need to review that matter with the national headquarters in Dallas, TX, before making a statement, but we would be pleased to provide any written additional comments that are appropriate.

Mr. SCHULZE. Mr. Beck.

Mr. BECK. Something less than 6 percent of Easter Seal income is passive income, and we don't have the exact figures because we don't collect information in that category from our 200 affiliated organizations.

But it is something less than 6 percent. That income is vital for providing ongoing services since over 40 percent of our revenue on an annual basis is contributed income, we do need those additional dollars.

Mr. SCHULZE. So—I had difficulty hearing you—do I understand 60 percent——

Mr. BECK. No, no, less than 6.

Mr. SCHULZE. You say 40 percent is contributed?

Mr. BECK. On an annual basis, yes.

Mr. SCHULZE. And less than 6 is passive. Where is the rest coming from?

Mr. BECK. Some 24 percent comes from Federal and State Government, Medicare and Medicaid, and grants from local and State government, 19 percent from program fees, service fees both through third party payors such as insurance companies and individuals; and 10 percent are sales to the public. The largest category under sales is income from the sale of goods from sheltered workshops.

So that is a distribution of that.

Mr. SCHULZE. I gather that you believe that passive income should not be treated any differently than the contributions?

Mr. BECK. That is correct. We don't believe it should be treated any differently. It is a vital source of income for us.

Ms. HAGER. Passive income of United Ways would be endowments. Many United Ways use that for emergencies that arise, venture grant funds, that type of activity. So we would want to see that continued to be treated——

Mr. SCHULZE. What is a venture grant?

Ms. HAGER. That is seed money typically offered by a United Way to agencies that are United Way agencies and in some communities to non-United Way agencies to provide one time startup funds for either a new service or expansion of an existing service.

Mr. SCHULZE. That is done with grants and not with loans, or is it done both ways?

Ms. HAGER. Each volunteer-led United Way would make their own choice. Most often it is typically done with a grant. It may require a local match but it may also involve a loan program.

Mr. SCHULZE. You use passive income and endowments for that?

Ms. HAGER. That is one use of those activities, yes.

Mr. SCHULZE. Do you use only income from passive income or do you go into the corpus in any case? Do you go into the principal in any instances or do you use only income from such investments?

Ms. HAGER. I don't know the answer to that. Ms. Barrett wants to respond.

Ms. BARRETT. Most endowment funds are restricted to use of the principal so that the United Way can have those funds to provide the annual income to do new things, meet new needs in the community and to use that for seed money or for emergency.

Mr. SCHULZE. So that generally you do not go into the corpus, you use only the donations.

Ms. BARRETT. That is correct.

Ms. JOHNSON. We have almost no endowments within our agency. I wish we had more. Our contributions come from individuals and businesses on an annual basis to support restricted kinds of programming. We have maybe two agencies that I know of that have an endowment and they would never use the principal, they use the interest from the endowment to further provide services to people.

Mr. SCHULZE. Do you think that that income should be treated differently than other incomes?

Ms. JOHNSON. No.

Mr. SCHULZE. Okay.

Thank you, panel. Thank you, Mr. Chairman.

Mr. FLIPPO. Thank you, Mr. Schulze.

Ms. Hager, statistics have been presented that concern the growth of the nonprofit sector since the 1970s. We have had a lot of growth in the nonprofit sector. Would you care to comment on that?

Ms. HAGER. Certainly.

Mr. FLIPPO. Why is that?

Ms. HAGER. I think one of the reasons is that there is a tremendous new awareness of the needs of our communities. I think that ought to be applauded. In most communities there is increasing responsiveness to needs. For example, the growth in recent years of individual domestic violence shelters, homes for runaways, tremendous growth in home health care for the elderly and respite services at the tremendous increase today in agencies that are serving AIDS families and victims. And agencies that respond to the particular needs in their communities of Hispanic or Asian families or newly arriving immigrants.

I think the second answer to the question really is that in some cases, government has chosen to encourage a growth in these services in recognition that not all of these services can be provided by the public sector alone. Government has encouraged such activities as you heard this morning, such as community residences, and other kinds of activities to help meet human service needs.

Mr. FLIPPO. Would any member of the panel care to comment on tax reform or other governmental actions, how they have affected your operations?

Ms. JOHNSON. I would like to speak to that. As a result of the cutbacks from government our agencies have had to try to find new ways of generating income to provide the services to those who need it who are unable to pay.

This is another reason why we would hope that there would not be any drastic changes in the law, because there is no other way that our agencies can provide services to those who cannot afford to pay without having these kinds of activities and resources.

Mr. **Flippo**. Any other member care to comment on that?

Ms. **Hager**. Only that our data has shown that cuts, federal cuts have amounted to approximately 36 percent since 1981 in areas such as food, clothing, housing and transportation, items that certainly none of us would ever want to be without.

In addition, with regard to the tax reform that has been enacted, while I think it would have merit for the country as a whole and we understand the need for that, the effect will be over the next 5 or 6 or 8 years, the estimate is that charities will lose up to $11 billion. That is not a funding stream that will easily be replaced.

Mr. **Beck**. In the case of Easter Seals, Mr. Chairman, it has not suffered cuts overall in income from government sources, but in fact the demand for its services have increased dramatically in many areas.

Mr. **Winkler**. Mr. Chairman, we believe that researchers that are now unable to get funds from national research grants are turning to the American Heart Association as well as other nonprofit organizations in search of funding for their studies and as the comment was, there was a reduction of approximately $11 billion due to income tax reform. There is a Harvard University professor, Lawrence Lindsey has suggested that elimination of the charitable contribution deduction for nonitemizers may yield a $6 billion loss among nonprofit entities for that one particular change in policy.

Mr. **Flippo**. Thank you.

Ms. **Johnson**. I would like to respond to your earlier question about the growth of not-for-profits since 1970. The growth in the number of not-for-profit organizations also reflects a growth in population and in the economy as a whole. Businesses also have grown in number during this period and during the period 1977-84 the number of not-for-profit organizations grew about 10 percent from the 740,000 to the 820,000, but during the same period the number of businesses grew about 19 percent from 14 million to about 18 million.

Mr. **Flippo**. Let me come to Mr. Winkler, and I use your heart book. I am grateful that you publish that book. But I am interested in that how you publish. Do you do that through a separate controlled subsidiary? Is the publication of your book by a separate controlled subsidiary to your Heart Association?

Mr. **Winkler**. The cook book is through a licensing agreement with a publisher.

Mr. **Flippo**. Sort of a royalty that you have there.

Mr. **Winkler**. That is my understanding, yes, sir.

Mr. **Flippo**. And that royalty then, is it exempt, income from that?

Mr. **Winkler**. That is my understanding, yes, sir.

Mr. **Flippo**. I see. Well, it is certainly a good book and I hope you will continue to publish it.

Mr. **Winkler**. Thank you very much, Mr. Chairman.

Mr. **Flippo**. Our chairman has now returned, and I will yield to the distinguished gentleman from Texas.

Chairman **Pickle**. I thank you.

I don't have any additional questions. If they have not asked each of you to respond to the specific recommendations of the Treasury in the seven categories, I would hope that you do respond to us immediately, to the Oversight Committee. Thank you very much.

[The following were subsequently received:]

SUPPLEMENTAL COMMENTS TO THE OVERSIGHT SUBCOMMITTEE OF THE HOUSE WAYS AND MEANS COMMITTEE ON THE UNRELATED BUSINESS INCOME TAX

United Way of America
July 15, 1987

These comments are in response to Chairman Pickle's request at the Subcommittee's June 22-30 hearings for written responses from witnesses to the following questions:

1. What is United Way of America's reaction to the Treasury Department's proposals on the Unrelated Business Income Tax presented in its testimony of June 22, 1987?

2. Do United Way of America and its members file Unrelated Business Income Tax (UBIT) returns (IRS Form 990T), and, if so, how many?

3. With regard to these filings, how much tax is paid?

4. Among United Way of America's members, how much income does United Way of America and its members earn from activities specifically exempt from UBIT?

1. Treasury Department's Proposals. United Way of America believes that the Treasury Department has identified some well balanced and objective approaches to problems in UBIT.

We agree with small business people that unfair competition ought to be curbed, but we caution the subcommittee not to define unfair competition or to draft legislation in such a way that it also curbs legitimate and critical human services just because some for-profit firms are present in the same fields. For-profit firms exist in every field of service in which charitable organizations serve their communities, but for-profit services serve a different purpose than nonprofit services. This distinction in purpose must be a key criterion in addressing inappropriate activities.

a. Relatedness Test.

United Way of America agrees with Treasury that the current test of relatedness to the nonprofit organization's mission ought to be retained. Substituting a commerciality or competition test as the pivotal point between taxable and exempt activities could eliminate many legitimate and appropriate charitable human services merely because some for-profits operate in the same service field.

The IRS may need more guidance in interpreting the relatedness test. We believe that when a nonprofit and a for-profit organization are operating in the same field, there is a distinct difference between the purpose, nature, and scope of the two activities. We would support a clarification of this distinction and efforts to develop guidelines that IRS can apply with regard to the relatedness test. We would be willing to work with IRS to develop guidelines.

b. Data and Reporting.

Treasury also indicated a need for more detailed reporting as a means of improving enforcement and compliance. We concur and offer the following specific suggestions:

- On form 990 require nonprofits to report income earned broken down by categories related to UBIT exemptions and business activities related to their charitable missions.
- Require nonprofits to report controlled subsidiaries on form 990 to give IRS notice of such relationships.
- Require IRS to publish all revenue rulings related to UBIT. Now only a few of these are published, and nonprofits are not given sufficient guidance for compliance with the law.

c. Exemption for Volunteer-Run Businesses.

We believe this exemption should be maintained. Its elimination carries too great a danger of destroying valid charitable activities. The difficulties of running a volunteer-based business are so great that this exemption would not encourage nonprofits to engage in unfair competition. Furthermore, where large numbers of volunteers may be available because they are members of religious orders or other groups which receive subsistence, food, and shelter as part of membership; the IRS already has developed a test to determine when these kinds of volunteers are actually employees. This test should be incorporated into regulation.

d. Exemption for the Convenience of Students, Patients, and Others.

We believe this exemption deserves scrutiny. However, as human service organizations rarely use this exemption, if at all, we do not have expertise in suggesting how this exemption might be changed.

e. Exemption for Sales of Donated Property.

We agree with Treasury that this exemption is appropriate and ought to be continued. Such donations constitute charitable contributions.

f. Allocation Rules for Expenses for UBIT Activities.

We agree with Treasury that this area may need to be scrutinized. However, nonprofit human services rarely engage in UBIT activities. Therefore, we do not have the expertise to suggest how these rules might be changed.

g. Increase in Deduction from UBIT from $1,000 to $5,000.

We support this proposal.

h. Subsidiaries.

We believe that the primary purpose of a nonprofit organization should be its charitable, educational, or religious mission. Therefore, we support Treasury's proposals to consider the activities of both the nonprofit parent and its subsidiaries in determining the primary purpose of the nonprofit organization. We agree also that a subsidiary should be deemed controlled by a nonprofit if the nonprofit holds a fifty percent interest in it. However, since we believe nonprofit human service agencies have few for-profit subsidiaries, we suggest that other organizations may have more expertise on the specific impact of these measures.

i. Exemption for Passive Income.

We agree with Treasury that such income should continue to be exempt for public charities. This income derives from charitable contributions, is used to further charitable activities, and does not entail an active role in business management which could be construed as unfair competition.

j. Passive Income from Royalties.

We are concerned about Treasury's proposal to tax the licensing of a charity's name or trademark for use by a commercial organization. While abuses occur in this area and ought to be addressed, this proposal could curtail legitimate charitable sales promotions by for-profit companies. In a charitable sales promotion, the charity gives a for-profit firm permission to use its name in its advertising to publicize the company's support for a charitable or civic cause and generate public support as well. The company advertises its intent to make a charitable contribution every time its product is purchased. The classic example is American Express's support for restoration of the Statue of Liberty by making a contribution every time a card holder used his American Express card to make a purchase. If a charity's permission to use its name in this manner is deemed a licensing agreement, these activities, which represent an increasingly important source of charitable contributions would be eroded and charities would not be able to do as much for their communites as they do now. Care must be taken not to define these activities as licensing agreements and the income as royalties.

k. Exemption for Research.

The nonprofit human service organizations that United Ways fund on the average do only a limited amount of research. These activites are related to their charitable missions, for example, the American Cancer Society's research on cancer causes and cures. The relatedness test would therefore appropriately exempt these activities from tax.

l. Partnerships and Joint Ventures.

These rules could be tightened. However, care should be taken not to harm nonprofit/for-profit partnerships for low and moderate income housing. Homelessness is one of the most critical problems this country faces. A major cause is the decline in affordable housing. A recent MIT study by Dr. Phillip Clay for the Neighborhood Reinvestment Corporation, estimates that by the year 2003, an additional 18.7 million Americans will be without affordable housing if current trends continue. Recent government policy changes are contributing to this decline. Funding for subsidized housing has been cut drastically and tax reform has severely restricted incentives for private investors. Additional restrictions on tax incentives for these activities will reduce nonprofit and private sector initiatives to meet these needs.

We would be happy to continue to work with the Oversight Subcommittee and the IRS to further develop any of these proposals.

2. United Way of America does not engage in unrelated business income activities and does not file a UBIT return. United Way of America's members consist of 1,329 of the approximately 2,300 United Ways across the country. Those United Ways which are not members are typically totally volunteer staffed. Each of our United Way members is an independent, separately incorporated 501(c)(3) charitable organization with its own IRS 501(c)(3) tax exempt status. Each United Way files annual 990 forms to the IRS.

To our knowledge, no United Way earns income subject to the Unrelated Business Income Tax. United Way income is primarily derived through solicitations for charitable contributions. Through these solicitations United Ways raised $2.44 billion for nonprofit human services in 1986.

United Ways are also affiliated with the over 37,000 nonprofit human service agencies which they fund. On the average nationwide, these agencies receive 13.3% of their incomes from United Ways' charitable fund raising efforts. United Ways oversee how these agencies spend United Way contributions and gather data on other sources of agency funding for United Way of America's annual allocations survey. However, each agency that United Ways fund is an autonomous, separately incorporated 501(c)(3) tax-exempt organization. United Ways do not control these agencies. Each United Way-funded agency is accountable to, and governed by, a volunteer board of community citizens which oversees its activities. Nevertheless, United Ways are concerned about complaints of unfair competition by business people. They want to do their part to increase the accountability of nonprofit agencies in these matters.

United Way of America's data on United Way-funded agencies has not previously identified UBIT filings. However, we have already taken steps to gather these data. United Way of America has worked with national nonprofit human service agencies, through the Grants and Contracts Project which is also submitting comments to the subcommittee, to develop a uniform survey format for gathering data on both related and unrelated business income activities. United Way of America's Task Force on For-Profit/Nonprofit Competition is distributing this survey to United Ways and urging them to gather this information from the agencies they fund and forward the results to United Way of America. The subcommittee's request for these data will add impetus to our ability to get a broad based response from United Ways and local agencies. This process, however, will take some time as we are also encouraging United Ways to build this data collection process around an educational program to ensure that the agencies fully understand their obligations under UBIT and comply with it.

3. Neither United Way of America nor United Ways file UBIT returns and do not, therefore, pay any tax. While some United Way-funded agencies may file UBIT

returns, we suspect that these activities are not prevalent and do not generate large amounts of income. Those national agencies representing local affiliates funded by United Ways which have gathered some data, have turned up few examples of UBIT activities. Furthermore, our many discussions with United Ways on the question of unfair competition have surfaced few examples of these types of activities. However, we plan to obtain these data as outlined in Section 2.

4. United Way of America's income comes primarily from charitable contributions which are raised by United Way members and paid to the national organization as dues. Ocassionally contributions are made directly to the national organization.

UNITED WAY MEMBERSHIPS AND DIRECT CONTRIBUTIONS	$19,289,376	(79.3%)
SPECIAL MEMBERSHIPS	$110,000*	
FEES FOR SERVICES RELATED TO UNITED WAY OF AMERICA'S CHARITABLE MISSION (Training, management, consultation, conferences.)	$4,137,268	(17.1%)
SALES OF GOODS RELATED TO UNITED WAY OF AMERICA'S CHARITABLE MISSION (Fund raising awards and recognition gifts.)	$430,970	(2%)
RENTAL INCOME (Use of office space and meeting facilities at national headquarters.)	$151,150	(1%)
INVESTMENT INCOME	$1,184,869	(5%)
MISCELLANEOUS	$56,268*	
TOTAL	$24,309,371	

* Less than 1%

Although United Way income is primarily derived from charitable contributions, a small amount of income comes from exemptions to UBIT. These are passive income and rental income.

United Ways' passive income derives from the investment of United Way contributions received from the annual campaign until allocation payments are made and from the income of restricted endowment funds — gifts and bequests of individuals. Investment income from regular United Way contributions is used for United Ways' charitable activities. This income helps to offset losses from contributions pledged which are not received because an employee changes his or her job or changes his mind about the contribution after the campaign. These funds may also be used for contingencies and emergencies, such as the loss of a government grant to an agency which may destabilize its operations and could shut the agency down without special assistance from United Way.

Many United Ways have endowment funds which prohibit the use of capital. In some situations capital may be used in unusual emergencies -- disasters such as fire, flood, tornado, which would require an extraordinary increase in community or agency need. The income from endowment funds is usually restricted to special purposes designated by the donor. These purposes are typically related to specific populations or needs such as the elderly, children, or emerging community needs. The income often helps United Ways to fund venture grants to encourage the development of new services or agencies designed to address new aspects of community problems -- for example, adult illiteracy, health care for the unemployed, or drug use among school children.

Restricted funds are also established for funds raised in capital campaigns to help nonprofit human service agencies acquire new facilities or maintain or renovate existing ones.

Many United Ways also have rental income from their office buildings. Typically an individual or a corporation donates a building or the funds to purchase a building. United Ways often seek buildings that are larger than needed for themselves in order to bring agencies and themselves into closer daily working relationships. These agencies pay rent to United Ways. Occasionally United Weys rent uneeded space to for-profit organizations, but this is the exception and not the rule.

We do not gather data on United Way income under the same categories as the UBIT exemptions. Data from our 1986 Survey of United Way Support Allocations, and Expenses shows income from the following sources:

ANNUAL CHARITABLE FUND RAISING CAMPAIGN	$1,207,575	(94.6%)
EXPENDITURES FROM RESTRICTED FUNDS (Includes capital funds used to operate or improve United Way's facility, government grants, and those foundation grants with restricted purposes, income from endowment funds only if spent.)	$21,798,000	(1.7%)
ALL OTHER SPENDABLE RESOURCES (Includes foundation grants without restricted uses, investment income from United Way campaign funds and rental income.)	$48,276,000	(3.8%)
TOTAL	$1,277,649,000*	

* Total is more than 100% due to rounding

Because this is a complex area of the law and changes can inadvertantly harm charitable activities designed to address critical community problems, we would respectfully request that the subcommittee circulate its proposals for comments on their impact on legitimate and appropriate charitable activities before finalizing them.

1250 Connecticut Avenue, N.W. Suite 360 Washington, D.C. 20036 202 822 9380

American Heart Association
Office of
Public Affairs

Dedicated to the reduction of premature death and disability from cardiovascular diseases and stroke.

July 15, 1987

The Honorable J. J. Pickle
House Committee on Ways and Means
Subcommittee on Oversight
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Pickle:

Pursuant to your request, the American Heart Association has reviewed the "initial observations and recommendations" of the Internal Revenue Service with regard to unrelated business income. Our comments are attached.

In addition, we wish to make the following information available for the record. During the June 26 Oversight Subcommittee hearing on the unrelated business income tax, Representative Schulze inquired of the American Heart Association witness whether our organization earned passive income, and if so, whether we thought that income "should be treated differently."

Passive income, in the nature of investment income, accounted for 9.4 percent of American Heart Association revenues in 1986. Income from investments is credited directly to the American Heart Association's unrestricted fund unless such income has been restricted by a donor. As such, it is immediately available for the broad range of research and professional and community education programs, which are the very basis for which our organization was formed. The American Heart Association supports the IRS's recommendation that passive investment income "continue to be exempt in the case of public charities."

The American Heart Association receives royalty income through three licensing agreements which govern the sale of a cookbook, a CPR training video, and a no-salt herb seasoning. In 1986, the amount of income earned through these licensing agreements amounted to less than one-half of one percent of our organization's total revenues. Nonetheless, we consider these activities vitally important because they directly relate to and promote the mission of the American Heart Association. We would be very concerned with any attempts to alter the tax treatment of these activities.

Finally, one additional comment. In your questions, Mr. Chairman, you inquired whether the American Heart Association would consider discontinuation of its current licensing agreements if a for-profit

WE'RE FIGHTING FOR
YOUR LIFE

Chairman of the Board
William B. Duiany, Esq.
President
Howard E. Morgan, M.D.
Chairman-Elect
W. W. Aston
President-Elect
Bernadine Healy, M.D.
Immediate Past Chairman of the Board
Robert H. Clark, Jr.
Immediate Past President
Kenneth I. Shine, M.D.
Secretary
William K. Vant Hof, Esq.
Treasurer
Oscar A. Gonzales
Vice Presidents:
Robert C. Bolander
Dennis DeSilvey, M.D.
Thomas S. Edgington, M.D.
Seymour Gordon, M.D.
Robert Havrilla
Donald R. Joseph
E. Eric Muirhead, M.D.
Herbert D. Ruttenberg, M.D.
Rodman D. Starke, M.D.
Michael Uffner
James Wiegmann
Thom R. Winkler
Chairman, Scientific Publishing Committee
Thomas W. Smith, M.D.
Chairman, Scientific Sessions Program Committee
August M. Watanabe, M.D.
Members-At-Large
Holly G. Atkinson, M.D.
Reagan H. Bradford, M.D., Ph.D.
Edward S. Cooper, M.D.
Susanna L. Cunningham, Ph.D.
Patricia Deck, R.N.
Anne Golden
William H. Hahn, Jr.
Jacquelyn A. Huebsch, R.N.
Clyde E. Johnson, Jr., Ph.D.
Gerard A. Kaiser, M.D.
David G. Palmer, Esq.
Philip S. Roush
William H. Weidman, M.D.
Myron L. Weisfeldt, M.D.
Executive Vice President
Dudley H. Hafner
Deputy Executive Vice President
M. Cass Wheeler
Senior Vice President, Scientific Affairs
Mary Jane Jesse, M.D.

entity suddenly offered virtually the same services. A complete answer requires a more thorough description of American Heart Association licensing agreements.

To date, the American Heart Association has entered into three licensing agreements. At the time each of these was developed no similar product existed in the marketplace. For example, 15 years ago the American Heart Association cookbook was developed at the request of and with the assistance of thousands of American Heart Association volunteers who sought a compilation of low-fat, low-cholesterol and low-sodium recipes. One of the recipes was for a no-salt herb seasoning. For years, the for-profit sector demonstrated little to no interest in developing similar products. It was not until consumer purchases made obvious that a demand existed for such items that development of like items took place.

To suggest that the American Heart Association should be required to withdraw from a marketplace that it alone created seems grossly unfair. If anything, it would provide the for-profit sector with an unfair competitive advantage.

As your Subcommittee continues its inquiry into the unrelated business activities of the nonprofit sector, please feel free to contact me.

Sincerely,

Scott D. Ballin

Scott D. Ballin
Vice President and Legislative Counsel

American Heart Association Responses
to
IRS Initial Observations and Recommendations

1. "Although we do not propose changes in the 'substantially related' standard, we do recommend more detailed reporting as a means of providing enforcement and compliance and of providing a basis for further review of the adequacy of the standard."

   If there was one fact that the five days of Oversight Subcommittee hearings made abundantly clear, it was that there exists a marked absence of knowledge regarding the unrelated business income producing activities of the nonprofit sector. Much of the information that continues to be shared is anecdotal in nature and not reflective of the entire nonprofit sector. The American Heart Association would encourage further review of nonprofit/commercial ventures. However, we would need to know the exact nature of any "more detailed reporting" requirement before commenting on its desirability.

2. "[W]e suggest that the scope of the exemptions for businesses operated by volunteers or for the convenience of students, patients and others should be reexamined."

   The American Heart Association does not engage in the above-described activities, and hence, feels it is inappropriate to comment on the recommendation.

3. "[W]e suggest that the rules for allocation of expenses be clarified to reflect the appropriate relationship between an organization's exempt functions and unrelated activities. In addition, we support retention of the 'fragmentation rule' and an increase in the specific deduction from unrelated business income from $1,000 to $5,000."

   Due to the limited nature of American Heart Association activities that have given rise to unrelated business income, i.e., the sale of advertising space in our scientific journals, the appropriate allocation of expenses has not been an issue. Likewise, our unrelated business activities do not require application of the "fragmentation rule". Hence, we can offer little valuable insight into these matters. We would, however, support an increase in the specific deduction from unrelated business income from $1,000 to $5,000.

4. "For purposes of characterizing otherwise tax-exempt passive income from subsidiaries as taxable, we suggest that the definition of a controlled subsidiary be broadened to include subsidiaries in which an exempt organization has more than a 50 percent interest in stock value or voting power . . . [F]or purposes of determining . . . the primary purpose of an organization . . ., we suggest that consideration be given to aggregating the activities of an exempt organization and its subsidiaries in appropriate cases."

   The American Heart Association does not engage in any unrelated business income activities through a taxable subsidiary. We do not feel it appropriate to comment on this recommendation.

5. "[W]e suggest that [passive investment] income should continue to be exempt in the case of public charities . . . . [W]e suggest that the exclusion for royalties should be narrowed to prevent avoidance of the tax on unrelated business income in certain circumstances."

The American Heart Association supports the Service's passive investment income recommendation. Because we do receive a small amount of revenue through royalties on related business activities, we would need to examine details of any proposed change to the current exclusion for royalties before commenting further.

6. "[A]dditional attention should be given to the definition of research and to requirements for public dissemination of the results of research."

   The American Heart Association does not earn income from research activities. Hence, comments on this proposal would be inappropriate.

7. "[W]e are concerned that current restrictions on partnership allocations between taxable and tax-exempt partners may not be adequate to prevent abuse. In addition, we have serious reservations whether current law is adequate to deal with issues raised by partnerships formed to conduct exempt activities of tax-exempt organizations."

   The IRS raises some concerns but does not make specific recommendations with regard to tax-exempt involvement in partnership arrangements. The American Heart Association would suggest that this is an area which should be further studied.

national
easter seal society
OVER 60 YEARS OF SERVICE TO INDIVIDUALS WITH DISABILITIES

Office of Governmental Affairs

July 13, 1987

The Honorable J.J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

RECEIVED
JUL 17 1987
Ways and Means
Subcommittee on Oversight

Dear Mr. Chairman:

I am writing as a follow-up to our testimony during the recent hearings your Subcommittee conducted on the unrelated business income tax. It is my understanding that you asked for comments on the Treasury Department's recommendations, which were submitted to the Subcommittee on June 22, 1987. We will comment on those recommendations which would most directly affect our organization. You may include this statement in the hearing record if you deem it appropriate.

We agree with the Treasury Department that the "substantially related" test has merit and believe that it should be retained. As we indicated in our testimony, it appears that the current regulatory scheme is workable. Our affiliates believe that the regulations developed under the "substantially related" test are adequate in distinguishing activities entitled to exemption from those that are not.

Generally, we agree with the Department's recommendation for "more detailed reporting as a means of improving enforcement and compliance." Improvements in data collection efforts appear warranted at this time. Any changes in current law would be ill-advised until more data is available.

We do not oppose a reexamination of the exemptions for businesses carried on for the convenience of students or patients. However, we doubt that there is sufficient abuse in the area to warrant a diversion of resources for study by the Department. We would strongly resist any change in the exception for activities carried on substantially by volunteers. Volunteers play a major role in the Easter Seal organization and the justification for the exception seems as strong now as it was when the law was originally enacted in 1950.

We agree with Treasury that the specific deduction of $1,000 allowed against unrelated business income should be increased to $5,000. This amount has not been adjusted since the law was enacted in 1950, so an increase to account for inflation is necessary.

We strongly concur with the Department's recommendation to maintain the exemption for passive investment income. Both our National Office and our affilated Societies across the country must maintain sufficient operating reserves for cashflow, unexpected contingencies and affiliate redevelopment. Therefore, some passive income is inevitable.

If passive income were taxed, it would result in a significant decrease in revenue. Simply put, it would mean a reduction in services.

We hope that our comments are useful. We appreciate the opportunity to express our views to the Subcommittee.

Sincerely,

Joseph D. Romer

Joseph D. Romer
Director of Governmental
Affairs

JDR/jc

Chairman PICKLE. The next panel will be the American Red Cross, Lewellys F. Barker M.D.; Alpha Therapeutic Corp., Mr. Matveld, accompanied by Mr. Colton; and the Hema Care Corp., Mr. Thomas Asher.

Lewellys F. Barker, M.D., is senior vice president of the American Red Cross; Mr. Edward Matveld is the representative of the Alpha Therapeutic Corp.; and Mr. Asher is representing the Hema Care Corp. We will ask Dr. Barker if he will present his testimony first.

STATEMENT OF LEWELLYS F. BARKER, M.D., SENIOR VICE PRESIDENT FOR DEVELOPMENT, AMERICAN RED CROSS

Dr. BARKER. Thank you, Mr. Chairman, for the privilege of appearing on the subject of competition between not-for-profit and for-profit organizations.

I have a prepared statement that I intended to deliver orally to you today, but I believe the subcommittee would be better served if I left my statement with you and used the available time to respond to some of the issues that have been raised over the past several days.

Chairman PICKLE. Thank you, that is satisfactory.

Dr. BARKER. The American Red Cross has not established any for-profit subsidiaries. The Red Cross files a 990-T on an amount of unrelated business income that is insubstantial in relation to our total revenue. This income is principally from parking fees on debt financed real properties. In 1986 the Red Cross reported unrelated business income tax totaling $500,000. This represents about five one-hundredths of 1 percent of our total revenue.

Chairman PICKLE. How much?

Dr. BARKER. Five one-hundredths of 1 percent. Red Cross practice with respect to income generating activity is cautious and responsible. When we are faced with a decision in which there is a question about relevance to our charitable purpose, we carefully review the legal principals involved and if circumstances warrant, we seek appropriate advice and approvals from the IRS. For example, in 1978 we sought approval from IRS for a proposed joint undertaking between Red Cross and a major commercial blood fractionator to build a blood facility. Our concern was to insure that the joint undertaking would not be considered an unrelated business activity.

Although approvals were obtained, the project was abandoned for economic reasons.

In the late 1960s we sought and received an IRS ruling that the processing of immune gamma globulin from surplus plasma would not generate UBIT and in 1984 we sought and received an IRS ruling that the sale of an automobile first aid kit would be related to our first aid training and would not therefore generate unrelated business income.

In addition to these external controls, the Red Cross has stringent internal controls for this area. Since July 1986 a policy on revenue generating activities that governs internal approval of new products and services has been in place. One of the chief criteria used to judge the appropriateness of an activity for which approval is sought is whether the product or service to be offered is related to the exempt purpose of the American Red Cross.

Red Cross chapters are provided with specific guidance to determine for themselves whether a particular product or service will result in the realization of unrelated business income.

Under this policy a number of proposed new services and products have been rejected as unsuitable activity for Red Cross.

In the past there have been questions raised concerning certain elements of our blood services activities. Our community blood services program has been reviewed by relevant Federal and State regulators and deemed to be consistent with our charitable purpose and our not-for-profit status.

Our blood services program is based upon two fundamental beliefs; first, that blood and its components like other tissues and organs should be obtained from voluntary donors rather than bought and sold in the marketplace. Second, that a full range of community blood services should be available to all who require them regardless of the cost or revenue potential of individual elements of that service.

We had the opportunity to make a preliminary review of the statement made by the representative of the Treasury Department to your committee. We intend to review it in detail but based on our preliminary review it appears to be thorough, well-reasoned and an objective analysis. We generally agree with its proposals that more and more and better documentation needs to be collected, through additional reporting requirements. This could enable IRS to more effectively enforce the tax laws and regulations presently in effect.

Thank you very much for the opportunity to appear before you, and I would be happy to answer any questions.

[The statement of Dr. Barker follows:]

STATEMENT OF LEWELLYS F. BARKER, SENIOR VICE PRESIDENT FOR DEVELOPMENT, AMERICAN RED CROSS

Thank you Mr. Chairman and members of the subcommittee for the privilege of appearing before you today on the subject of competition between not-for-profit and for-profit organizations. I am Lewellys F. Barker, senior vice president for development of the American Red Cross. My objective today is to provide you with a sense of both the uniqueness of the Red Cross, and the importance of its mission. Our request is that any action that is taken to respond to the concerns of small businesses not weaken the unique ability of the American Red Cross and of similar not-for-profit organizations to serve the public.

The American Red Cross acknowledges the importance of a vital small business community. For the Red Cross, small businesses are not competitors, but sources of volunteers, financial contributors, and blood donors. Small businesses are also beneficiaries of Red Cross disaster preparedness efforts and their owners and employees are recipients of food and shelter when disaster strikes, of life-saving blood and blood products when they are needed, and of training in first aid and safety skills.

The mission of the American Red Cross is to improve the quality of human life; to enhance self-reliance and concern for others; and to help people avoid, prepare for, and cope with emergencies. The Red Cross accomplishes its mission through services that are governed and directed by volunteers and are consistent with the provision of its congressional charter and the principles of the International Red Cross.

In carrying out its mission, the American Red Cross provides services to members of our Armed Forces, maintains a worldwide communication network to connect members of the Armed Forces with their families, carries on a program of voluntary relief for victims of disaster, offers a wide variety of health and safety courses in the local community and in the workplace, and, most recently, has provided factual reliable information about AIDS to over 30 million Americans through its AIDS public education program.

At the request of the United States Government, the Red Cross has taught swimming to service men during World War II, assisted with the Bay-of-Pigs prisoner release, managed refugee camps for Southeast Asians, and helped locate persons eligible for new Social Security benefits. At the State and municipal government level, we routinely work with local agencies to prepare communities for national and human caused disasters.

In addition, a very special program for American Red Cross is its community blood services. For more than 50 years, Red Cross has collected and processed blood and its components, first for Britain in World War II and then for our own Armed Forces. During the five decades since the program was instituted, the American Red Cross has collected and processed more than 83 million units of blood and blood components for civilian and military needs.

Today, we provide more than one-half the Nation's blood supply, collecting more than six million units from volunteer donors who have no other motivation in giving blood than in helping another person in need. Those units are processed into more than 16.5 million transfusible blood products, serving patients in more than 4,000 hospitals and other medical facilities.

With the exception of our blood services, Red Cross programs are supported by publicly contributed funds, about 90 percent of which come to the Red Cross through the participation of Red Cross chapters in local United Way campaigns. Last year, charitable contributions to the Red Cross totaled over $342 million. Since 1977, our blood services program, by Red Cross board policy, has been self sustaining, with controls to ensure that revenues derived from the program do not exceed the anticipated or actual financial requirements of the program. Last year blood services revenues, all of which are returned to the program, totaled $485 million. Because of all of our activities are substantially related to our charitable purpose, our sole unrelated business income, as reflected in our tax filing, is derived from debt financed real property. Last year our unrelated business income was about .05 of 1 percent of our total income.

Although in the past questions have been raised concerning certain elements of our blood services activities, I can say without reservation that our community blood services program has been reviewed by the relevant Federal and State regulators and have been deemed to be consistent with our charitable purpose and our not-for-profit status. Our blood services program is based upon two fundamental beliefs—first that blood and its components, like other tissues and organs, are not products to be bought and sold by donors in the marketplace and, two, that a full range of community blood services should be available to all who require it, regardless of the profitability of individual elements of that service.

Whenever we face a decision to provide a new service or to provide more of an existing service, we must ask ourselves how it is to be paid for. The idea that every important public service will be immediately supported by philanthropic contributions is not realistic. First of all, philanthropic giving, though extensive, is far less than is needed to support even a portion of the not-for-profit organizations currently providing important services.

Second, not-for-profits have traditionally supported themselves in part—and often a very large part—through fees.

Third, it is through the creative combination of philanthropy, fees, and the time and energy of volunteers, that not-for-profits have been able to serve the public so well and to fulfill our commitment never to deny services to any individual because of his or her inability pay.

A great strength of the American system is that it has room for private enterprise and for the non-profit provision of human services. Sometimes the line between these functions becomes blurred. This, however, seems a small price to pay for the opportunity for private citizens to organize to help their neighbor without constant recourse to government. If the line between the private for-profit and not-for-profit sectors requires some clarification from time to time, the method lies in enforcement of existing laws. Increased regulation of the not-for-profit sector will have a chilling effect on the creative forces of philanthropy and volunteerism that energize it.

Thank you again Mr. Chairman, for the privilege of appearing before you today. I would be pleased to respond to any question you or other members of the subcommittee might have.

Chairman PICKLE. We thank you and we will go to the other panelists and come back.

I will ask Mr. Edward Matveld, representing the Alpha Therapeutic Corp., if he would proceed.

STATEMENT OF H. EDWARD MATVELD, VICE PRESIDENT, CONTROLLER AND TREASURER, ALPHA THERAPEUTIC CORP., ACCOMPANIED BY EDWARD A. COLTON, GENERAL COUNSEL

Mr. **Matveld**. Thank you. We have submitted a paper to this subcommittee which describes the situation where a nonprofit organization, the American Red Cross, is regularly engaged in competitive sale of plasma products with other for-profit entities such as Alpha Therapeutic Corporation, Cutter Biological and Armour Pharmaceutical.

Alpha is unaware of any unrelated business income being reported to the IRS by the American Red Cross. Therefore, we have concluded it is now in unfair competition with the American Red Cross from a tax point of view.

Our focus is on the blood plasma industry and plasma is one of the components of whole blood that is fractionated into so-called derivatives that allow physicians to prescribe blood component therapy. Among other activities, the American Red Cross collects whole blood from volunteer donors, sells primary components such as packed red cells and platelets and then salvages the leftover plasma for use in producing plasma products. Operating costs may be spread over several products without having to burden the salvage plasma.

On the other hand, plasmapheresis centers extract only plasma from its paid donors and end up with a costly plasma that must absorb all operating costs of the plasmapheresis centers. Hence, the Red Cross has a major competitive edge from sourcing the raw material, the plasma.

Before continuing, it is imperative to clarify that Alpha Therapeutic Corp. has a sincere respect for the many life-saving activities of the American Red Cross. In no way do we wish to defame the name or the activities of the American Red Cross. Our purpose, once again, is to respond to requests for information regarding inequitable income taxation situations between nonprofit and for-profit organizations in the United States.

There has been a substantial increase in the revenue dollars for the blood services program of American Red Cross. In 1971, the blood services program revenues of $33 million were 19 percent of the total American Red Cross revenues. In 1985, the blood services program revenues had grown to $455 million or 54 percent of the total American Red Cross revenues.

This increase highlights the fact that the plasma services division has grown disproportionately so that its revenues are not substantially related to the performance of the original tax-exempt purpose.

Further, statistics reveal excesses of revenues over expenses referred to by some inappropriately as profits of $16 to $26 million per year over the last few years. However, these excesses are after deductions for property acquisitions of about $25 million per year. A more realistic excess reveals $40 to $50 million per year.

Through 1985, the blood services program had accumulated $187 million in such excess revenues. It therefore appears appropriate for Congress to review the American Red Cross charter and mission as they pertain to competitive for-profit activities.

The American Red Cross employs pricing policies that are detrimental to the for-profit sector of the blood plasma industry. This is possible since the American Red Cross basically has a free supply of plasma and the American Red Cross is a 501(c)(3) tax-exempt organization.

A comparison of the revenues and profits shows the American Red Cross with $80 revenue and $51 profit per liter of plasma which it has fractionated. The rest of the industry generates about $90 revenue and about $11 profit per liter of plasma.

The nonprofit American Red Cross enjoys about five times the profit per liter of plasma over the for-profit rest of the industry. These added profits also permit significant reductions in selling prices of competitive products.

The framework of the subcommittee's review included a question as to what extent tax-exempt organizations are engaging in commercial activities with for-profit businesses through joint ventures, partnerships, et cetera.

For several years the American Red Cross has contracted with Baxter Travenol, one of the largest for-profit plasma fractionators in the world, to have its plasma fractionated into its products. In 1986, the relationship was expanded by a unique long-term agreement known as the value-managed relationship, VMR. Under the VMR, Baxter Travenol supplies blood containers and related products to the American Red Cross.

Additionally, the agreements call for the two organizations to combine talents in a variety of projects for research and product development, management services, and consulting.

Shortly before the agreement, Baxter Travenol made a $500,000 grant to the American Red Cross. We are also advised that effective January 1, 1987, the American Red Cross will no longer purchase plastic bags from Cutter Biological regardless of the price or the quality.

The relationship of the American Red Cross and Baxter Travenol could grow into a very, very dominant force in the plasma industry.

Several recent actions indicate an aggressive posture by the ARC. The ARC has now ventured into plasmapheresis and has opened two new plasmapheresis centers. Previously the ARC concentrated solely on the collection of whole blood. The incorporation of several previously independent blood centers in to the ARC system. Foreign expansion by successful bidding of supply to the Canadian Red Cross of AHF and albumin.

In summary, Alpha Therapeutic Corp. believes by every measure used by the courts and the IRS, the ARC plasma business is not substantially related to the purposes which form the basis of the American Red Cross exemption under 501(c)(3) of the Internal Revenue Code.

Further, sections 511 through 513 of the IRS Code were adopted to see that a tax-exempt organization cannot generate revenues by engaging in business which competes with private industry unless it competes on a fair basis, by paying taxes.

Thank you.

Chairman Pickle. I thank you, Mr. Matveld.

[The statement of Mr. Matveld follows:]

Alpha THERAPEUTIC CORPORATION®
5555 Valley Boulevard, Los Angeles CA 90032
(213) 225-2221 TLX: 4997369

June 17, 1987

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington, D.C. 20515

Re: Unfair Competition of American Red Cross Arising Out of
Its Tax Exempt Plasma Derivatives Business

Dear Mr. Chairman:

The purpose of this paper is to bring to the attention of the honorable members of the Oversight Subcommittee the undeniable fact that the Blood Services Division of the American Red Cross (ARC) appears to be abusing its tax exempt status. Based upon information available to us, it is our understanding that the ARC is not subject to tax on the revenue of its Blood Services as "unrelated business income". As you know, unrelated business income tax (UBI) is imposed on taxable income of a nonprofit organization from an unrelated trade or business that is regularly carried on by the organization (see Section 512 of the I.R.C). In addition Revenue Ruling 66-323, 1966-2 C.B. 216, modified by Revenue Ruling 78-145, 1978-1 C.B. 169, stipulates that the sale of blood products by a blood bank is an unrelated activity and therefore subject to UBI tax. However, Revenue Ruling 78-145 completely reverses itself by stating that sales of by-product plasma and salvage plasma from whole blood are not unrelated business income. This distinction makes absolutely no sense at all and appears to be directed to the special interest of the ARC.

As stated in S. Rep. No. 2375, 81st. Cong., 2d. Sess. 28-29 (1950), "The problem at which the tax on unrelated business income is directed is primarily that of unfair competition." UBI tax was initially aimed at non profit organizations for unfair competition with for-profits organizations. Unfortunately, the law has failed to fulfill its intended purpose because it contains numerous legal ambiguities and overly broad exceptions. As a result the ARC is now competing head-on with for-profit blood plasmapheresis and fractionation firms as well as for-profit blood banks. This paper demonstrates the significant impact that the ARC has upon the plasmapheresis and fractionation industry.

I.

BACKGROUND INFORMATION ON WHOLE BLOOD, HUMAN SOURCE PLASMA, AND PLASMA DERIVATIVE PRODUCTS

Blood consists of four basic "components": red cells, white cells, platelets, and plasma. Plasma is the yellowish fluid in which the various other components are suspended. In addition to the cellular components and platelets, the plasma transports nutrients to the cells of the body and cellular wastes to the kidneys and liver for excretion. Plasma contains minerals and transports hormones and enzymes. Plasma also contains many specialized proteins. Plasma is the raw material for a variety of manufactured pharmaceuticals, known as "derivatives". The most important protein derivatives are albumin, which prevents the escape of water through the walls of blood vessels; factor VIII, an antihemophilic factor, which is necessary for blood to clot; and gamma globulins, which protect against disease.

The past quarter century has witnessed the development of significant applications of blood, components, and derivatives to the treatment and prevention of disease and disorders. Much of this advance stemmed from the recognition that components and plasma derivatives could provide efficacious therapy for a wide spectrum of conditions not necessarily amenable to treatment with whole blood.

For example, a plasma derivative known as antihemophilic factor (factor VIII) has been developed to the point that hemophilia patients in the United States can now lead relatively normal lives. Serum albumin is vital in treatment of burn victims to replace body fluids. Among the gamma globulins now being derived from plasma are those that immunize against tetanus, pertussis, measles, mumps, hepatitis, and rabies. Rh-immune globulin prevents the build-up of antibodies in a Rh-negative mother that could be fatal for her Rh-positive baby. A recent development has been the introduction of live viral antigens for human vaccine preparation, such as hepatitis B virus. Blood typing sera made from plasma are indispensable to assure that transfusion products (such as whole blood) are properly matched to recipients' blood types. Without them, blood banking as practiced today would not be possible. Plasma is also used to manufacture non-blood banking products such as chemistry control reagents, which are used in every hospital and clinical laboratory in the United States.

These biological products have the following points in common: (1) their source or raw material is human plasma; (2) the plasma and the products are processed and manufactured in accordance with Food and Drug Administration ("FDA") regulations; (3) the proprietary industry has been responsible for the development of most if not all of these products and processes; and (4) like any prescription drug, these products must be approved by the FDA prior to being licensed for clinical use.

The commerce in plasma products consists of three distinct phases: collection of the raw material, manufacturing, and marketing and distribution.

Plasma can be collected by plasmapheresis, the process used by the Industry; this plasma is known as Source Plasma (Human). Plasmapheresis is the process by which blood is collected from a donor, the plasma separated from the red blood cells using a centrifuge machine, and the donor's own red blood cells returned to his body. Plasma can also be removed from the whole blood, which has been collected for transfusion into patients, at one of three points in time: by extracting and freezing it within six hours of collection to capture the heat labile factor VIII ("fresh frozen plasma"), by retention after the red cell component has been transfused for a therapeutic purpose, or by extraction after the storage life of whole blood has expired ("recovered" plasma). Both recovered and source plasma are suitable for manufacture into the pharmaceutical products described above, although source plasma is suitable for a wider range of finished products.

The manufacturing process for converting plasma into pharmaceuticals is called "fractionation", which is essentially a process of separating the various plasma proteins from each other. It requires sophisticated and costly technology, equipment, and expertise. The end result of the manufacturing process is a sterile, pyrogen-free product which meets specified standards of potency and therapeutic efficacy. The manufacture of products from plasma is extensively regulated by the FDA pursuant to Section 351 of the Public Health Service Act. Blood typing sera and chemistry control reagents are manufactured from plasma by several proprietary firms, frequently referred to as "diagnostic reagent manufacturers".

As described in detail below, the ARC is engaged in the plasma business in a significant way, from collection of plasma through distribution and sale of a wide range of plasma products. Its business practices imitate and compete directly with the business practices of proprietary firms. The ARC's plasma activities constitute a trade or business, regularly carried on, which is not substantially related to the ARC's exempt purposes. As a result of its tax exempt status, the ARC enjoys a decisive competitive advantage in the marketplace: The ARC does not pay any income tax on revenues derived from its plasma business.

II.

THE ARC'S BLOOD SERVICES DIVISION'S REVENUES ARE NOT SUBSTANTIALLY RELATED TO THE PERFORMANCE OF ITS ORIGINAL TAX EXEMPT PURPOSE

The ARC is the nation's largest public charitable organization. It was chartered by Congress in 1905[1] as part of the International ARC, an organization begun in the late nineteenth century to provide battlefield medical relief for wounded soldiers.

As mandated by Congress, the ARC was charged with provision of wartime aid to the military sick and wounded, and, as well,[2]

> ... to continue and carry on a system of national and international relief in time of peace and apply the same in mitigating the sufferings caused by pestilence, famine, fire, floods, and other great national calamities, and to devise and carry on measures for preventing the same.

In 1947 Congress streamlined the structure and organization of the ARC, but made no changes in its fundamental mission or purposes.[3] A 1953 law extended the scope of ARC aid to the Armed Services to include peacetime activities of the same nature as those provided during wartime, such as entertainment and social activities.[4]

The ARC's activities now include disaster relief, water safety, first aid and nursing programs, assistance to the military, their families and veterans, and its blood program. The ARC has also committed itself to a relatively new program, entitled "Health Services Plan," to "provide education and services" for people in their communities. [5] As a consequence of these highly visible activities, the ARC is perceived by the public as a benevolent group of volunteers who make the donation of blood as painless and socially significant as possible. The public is not generally aware of the complexity of the ARC's organization, its corporate purposes which underly its charitable activities, or its incredible wealth.

Besides being the nation's largest public charity, the ARC is one of the richest. Its net assets, including its chapters and blood services, as of June 30, 1985 (the latest data available), totalled more than $1,067,000,000. [6] Unrestricted net assets (not including land, buildings, equipment, endowment, or donor-restricted assets) amounted to $578,488,000; land, buildings, and equipment added another $340,536,000; the cost value of investments as of June 30, 1985 was $424,040,000. All of these assets grew significantly over the previous year.

Total revenue grew from $484,300,000 in 1980 to more than $850,000,000 in 1985. Blood Services revenue increased from $241,155,000 in 1980 to $455,597,000 in 1985.

The Blood Services Program is the Largest Single Program of the ARC.

The following table shows the Blood Program's dramatic growth over the past ten years, as compared with the ARC's other programs:

ARC Revenues - Expense Data (millions)

Revenues	1971	1985	Percentage Increase	Annual Rate of Growth
Campaign Contributions	$114.4	$283.1	247.5%	16.5%
BLOOD PROGRAM REVENUES	33.0	455.6	1,380.6%	92.0%
Endowment & Portfolio	21.3	91.1	427.7%	28.5%
Other	5.5	20.9	380.0%	25.3%
Total	$175.1	$850.7		

Program Outlays	1971	1985	Percentage Increase	Annual Rate of Growth
Armed Forces Related Service	$ 58.4	$ 68.4	17.0%	1.13%
Disaster Relief	25.5	84.9	332.9%	22.2%
BLOOD PROGRAM EXPENSES	48.0	452.9	943.5%	62.9%
Other Programs	23.6	108.5	460.2%	30.7%
Management & Support Outlays	23.8	67.0	281.5%	18.8%
Total	$179.3	$781.9		

In the past, the Red Cross's Blood Services Program generated an excess of revenues over expenses with impressive consistency. In only one year since 1977 has the ARC Blood Services Program reported in the organization's Form 990 tax return a deficiency in "revenue over operating costs of operations and property acquisitions":

1977	excess	$6,502,738
1978	deficiency	(661,382)
1979	excess	$2,009,382
1980	excess	$10,970,000
1981	excess	$13,281,000
1982	excess	$25,997,000
1983	Data not available	
1984	excess	$23.415,000**
1985	excess	$16,680,000*

*Net of Property Acquisitions - $24,548,000
**Net of Property Acquisitions - $24,228,000

These substantial contributions made by the Blood Program to the overall ARC net assets strongly indicates that the ARC has significantly and intentionally deviated from its charter which was set forth by Congress in 1905. Consequently, it is indeed appropriate that Congress through this Subcommittee again review the American ARC's charter and mission as it relates to "competitive for profit" activities.

III.

THE ARC's PRICING POLICIES ARE INTENDED TO UNDERMINE THE PLASMAPHERESIS AND FRACTIONATION INDUSTRY BY UNFAIR PRICING COMPETITION WHICH IS SUPPORTED BY THE ARC'S TAX EMEMPT STATUS

The most significant effect of the ARC against the for-profit blood plasmapheresis and fractionation industry is price cutting. Since the ARC is exempt from both federal and state taxes it can and it has attempted to increase its market share by reducing prices below those charged by its for-profit competitors. In fact it is the goal of the ARC to take over and control all blood services in America as will be shown later in this document.

To emphasize the fact that the ARC's pricing policies are detrimental to the fractionation industry it should be noted that the ARC collects and distributes about half of the whole blood and components used in the U.S. During the course of these operations, the ARC has available to it, substantial amounts of plasma -- estimated at 800,000 liters annually -- which is fractionated under contract by Baxter Travenol for marketing and sale of finished product by the ARC. The ARC holds two unique and potent advantages not shared by the commercial plasma fractionation firms: a "free" supply of plasma (excluding handling expenses) because of ARC's source of voluntary donors (see Exhibit A), and the ARC's tax-exempt status under 501(c)(3), i.e., not subject to any federal or state income tax on its derived profits.

At present it is quite clear that the ARC's pricing policy and its respective costs regarding the fractionation of its plasma products have a major influence on the industry and its direction. Currently the ARC will sell heat-treated antihemophilic factor (also referred to as factor VIII) product to anyone at 7 cents per unit. To large purchasing customers the ARC will sell heat-treated antihemophilic Factor (AHF) product for even lower prices per unit. At this time other manufacturers' cost for the rest of the industry is equal to or is greater than the ARC's current selling price of heat-treated AHF units. By similar analogy, the ARC currently sells Normal Serum Albumin at approximately $26 to $27 a unit which is less than other current Industry manufacturer's cost for the same product. The following diagram shows a comparison of the ARC and Industry cost and selling prices.

Sources of Human Plasma

American Red Cros
Volunteer Donors (1,500,000 liters)
Packed Red Blood Cells----
Platelets-----------------
Whole Blood---------------
(All Costs Recovered)
Plasma for Fractionation ($0 Cost)

Others
Paid Donors (6,000,000 liters)
Plasma for Fractionation ($50.00 cost)

Selling Prices		
Albumin	$25 per vial	$32 per vial
Factor VIII	$.07 per unit	$.14 per unit
Factor IX	$.05 per unit	$.09 per unit

In addition, the following is a comparison of ARC and Industry Profits and Costs.

PROFIT & COST ANALYSIS PER LITER OF PLASMA

AMERICAN RED CROSS	ARC	REST OF INDUSTRY
Sales Price of Finished Product	$80.00*	$90.00**
Less Plasma Cost	0	< 50.00>
Less Manufacturing Cost	0	< 14.00>
Less Hyland (Baxter Travenol) Fractionation Charge	(25.00)	0
Profit Before Freight	55.00	$26.00
Less All Freight	<4.00>	<4.00>
Net Profit Before Tax	51.00	$22.00
Less Taxes at 50% (Fed & State)	N/A	<11.00>
NET PROFIT AFTER TAXES	$51.00	$11.00

*Factor VIII and Albumin / **Factor VIII, Factor IX, IVGG and Albumin

As can be seen, the ARC nets almost five times more in profits from the same liter of plasma than the Industry average. This is because the ARC does not pay for its plasma source material and because the ARC does not pay any income taxes because of its non-profit status. The results therefrom allow the ARC to substantially influence the market price for AHF and NSA; an obvious disadvantage to the remaining competitors within the plasma Industry.

In the commercial industry, the cost of plasma to a fractionator is estimated at about 70% of its direct costs and processing at about 30%. 7/ By contrast, plasma for fractionation has relatively little cost to the ARC. As a senior ARC official summarized, "if you've already transfused the packed red cells, platelets, etc. you can have recouped 90% of your costs before you ever get to the final product [plasma]." 8/ The result is the generation of substantial revenues in excess of costs.

IV.

THE ARC'S ALLIANCE WITH BAXTER TRAVENOL IS NOT CONSISTENT WITH ITS TAX EXEMPT STATUS AND SUBSTANTIALLY IMPACTS ON THE U.S.PLASMA/FRACTIONATION INDUSTRY

As announced in the ARC's Blood Services Bulletin, March 26, 1986, the so-called "Value Managed Relationship" (VMR) alliance between the ARC and Baxter Travenol represents a combination of the two largest entities involved in this nation's collection and provision of blood, blood components and blood-derived products. The VMR has been described by the ARC's President, Richard F. Schubert, as "...a new way for suppliers and customers to do business". By the ARC locking into a for profit relationship with Baxter Travenol, it is also locking out business relationships with other suppliers. Schubert stated that "the VMR will enhance the premier position that each organization holds in its respective product and service areas". The bottom line is the creation of a monopolistic relationship at the expense of competition and the U.S. taxpayer.

These same two parties previously were contractually bound by a plasma fractionation contract in 1985 for fractionation of finished product by Baxter Travenol from ARC plasma. Further, the ARC has acquired rights to purchase Baxter Travenol's fractionation facility in the near future.

Baxter Travenol, with its acquisition of American Hospital Supply, is the largest supplier of hospital and medical products in the world. It has secured and maintained a classical monopoly position in the U.S. blood bag market and is a major factor in the collection, fractionation and sale of plasma-derived products. To this end, we are advised that the ARC has notified Cutter Biological that effective on January 1, 1987, the ARC will no longer buy Cutter's plastic blood bags regardless of whether or not Cutter offers a better price or higher quality product. In effect, the VMR is the vehicle through which the ARC has terminated its blood bag business with Cutter.

The above demonstrates the developments now underway, or which can be reasonably foreseen, that can or will lead to a U.S. blood and plasma system composed of the American ARC and the largest commercial firm of its kind in the world -- Baxter Travenol.

The ARC continues its absorption of independent blood centers and the opening of two new plasmapheresis centers, which will increase its plasma supply. Consequently its inherent cost advantages will be sustained and will also expand the current ARC pricing domination. The present ARC/Baxter Travenol relationship represents about 40% of the U.S. AHF market; and even a modest increase in plasma in the U.S. market could quickly lead to an AHF market share of two-thirds. The current 25% share of the U.S. Albumin market enjoyed by ARC/Baxter Travenol is also expected to increase substantially.

As the other three non-aligned commercial firms -- Cutter, Alpha and Armour -- are unable to profitably compete in the U.S. market and are faced with exit prospects, another ARC/Baxter Travenol factor is coming down on independent and community blood providers. Lacking the blood bag and supply price advantage of the ARC, or the magnitude of its unique profit resources, they will be unable to compete with the dominant ARC position attained in large part from its Baxter Travenol alliance, expediting the takeover process.

V.

THE ARC INTENDS TO TAKE OVER THE U.S. INDUSTRY BY CONTINUED EXPANSION OF ITS BLOOD SERVICES DIVISION INTO THE MARKET PLACE OF FOR PROFIT COMPANIES WITH THE SUPPORT OF ITS TAX EXEMPT STATUS

Another impact of substantial magnitude would be that experienced by the portion of the industry collecting plasma throughout the U.S. This is done through approximately 350 FDA regulated plasma collection facilities providing well over 10 million plasma collection procedures annually. The majority of these centers are independently owned, providing plasma to the industry product fractionators.

As the commercial plasma fractionators lose market share to the alliance and utilize lesser quantities of plasma, correspondingly fewer plasma centers will be needed. The ultimate effect when the VMR alliance can totally source all plasma will be the elimination of this industry segment which employs approximately 6,000 and serves as the source of specialized hyperimmune globulins required for production of vaccines.

Significant changes to the current industry structure will occur when there are too few independent blood centers to economically serve as a viable source of supply for the needs of remaining plasma fractionation firms -- and too few suppliers to serve as a viable alternative to the ARC for the remaining independent blood centers.

Recent evidence of these developments include:

-- The merger of the previously independent South Florida Blood Service into the ARC.

-- The Blood Center of Northern Illinois and the ARC Mid-American Region plan a three year joint venture, pending consideration of a later merger. Cited by the independent center was "access to more resources".

-- Cutter is shut out of the ARC blood bag market. Baxter Travenol is to be the exclusive supplier...without bidding.

-- Victor Schmitt, ARC Vice President for Medical Operations, on May 8-9, 1986 indicated that the ARC currently supplies 29% of the U.S. Albumin and the ARC was exploring expanded plasmapheresis operations, and anticipates a trend toward increased ARC participation in meeting plasma needs within the next five years.

-- The Chief Medical Officer, Blood Services, ARC Oklahoma Region, in The Red Cross News, December, 1985, stated that if the competition has neither the resources nor the desire to provide a full line of products and services, the pricing of Red Cross products can then be structured to reflect this weakness. The price of products not supplied by others can be increased.

-- A report that after the VMR alliance with Baxter Travenol the ARC has refused to assist independent centers with rare donor bloods;

-- An abrupt discontinuance of an agreement with a Pittsburgh independent center on blood supply.

-- Shortly before the VMR alliance was announced, Baxter Travenol made a $500,000 research grant to ARC.

-- Both the ARC and Baxter Travenol have assigned personnel to the other party's facilities as a result of the VMR.

-- Recently the ARC won bids for a large majority of a bid contract for supply to the Canadian Red Cross of AHF and albumin. Other bidders were Cutter, Armour and Alpha. Note that Baxter Travenol was not among the bidders. Is the ARC expanding its dominant position outside the U.S. on the basis that the Canadian ARC was a sister company?

-- In fiscal year 1985 ARC reports $41.2 million in "excess of revenues over expenses" for blood services; revenues were $466 million.

The so-called VMR is typically justified by the ARC as a way to "face present-day health care challenges, specifically cost containment and competition." Some resulting measures, such as lowered ARC plasma product prices and favorable Baxter Travenol supply prices to ARC, may indeed represent surface contributions to these goals. But their ultimate and longer-term calculation and effect will be to place the U.S. blood services complex in the hands of an alliance, or monopoly, composed of the not-for-profit ARC and the distinctly for-profit Baxter Travenol.

VI.

THE ARC IS ENGAGED IN THE PRODUCTION OF ACTIVE INCOME PRODUCING ACTIVITIES THAT ARE ALSO BEING CARRIED ON BY TAXABLE BUSINESSES

The backbone for an organization's purposes is its articles of incorporation or charter.9/ By its charter, the ARC's purposes relate generally to two broad tax-exempt areas: services to the Armed Forces and disaster relief. The words "blood," "plasma" and "derivatives" do not appear in the ARC charter. In the years since World War II, the organization's charter has never been amended by Congress to encompass a peace-time blood collection program. While it can be argued that the peace-time blood program is subsumed within the rubric of disaster relief, it is difficult to argue that the manufacture and marketing of derivatives is anything but the manufacture and distribution of pharmaceutical products. Plasma products of all sorts, like any other drug products, are a routine part of health care. Albumin and Factor VIII are used routinely in a variety of therapeutic settings; globulins are used to prevent disease before it occurs; typing sera and chemical reagents are used daily in hospital blood banks and in laboratories.

The ARC's plasma activities clearly provide income -- indeed profits -- for the ARC. Congress, however, specifically precluded consideration of the organization's need for income as justification for not taxing activities unrelated to an organization's exempt purposes.[10]

Thus, the sole focus is on the question whether the plasma business is "substantially related" to the ARC's exempt military services and disaster-relief purposes. Business activities are "related" to an organization's exempt purposes if they have a "causal relationship to the achievement of exempt purposes." The activities are "substantially related" where the "causal relationship is a substantial one."[11] A substantial causal relationship may be found to exist where the production or distribution of goods or performance of services "contribute importantly to the accomplishment" of the exempt purposes [12] and [13] in determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve.

The courts have had few occasions to consider issues similar to those here addressed. But in each case, business activity similar to the ARC's plasma program was found to generate unrelated business taxable income.

Any argument by the ARC that it is selling products which result from the performance of exempt functions since its plasma comes largely, though not entirely, from whole blood collections, is misplaced. The regulations recognize that taxable unrelated business income does not arise from the sale of products which result from the performance of exempt functions[14] if the product is sold in substantially the same state it is in on completion of the exempt functions.... On the other hand, if a product resulting from an exempt function is utilized or exploited in further business endeavor beyond that reasonably appropriate or necessary for disposition in the state it is in upon completion of exempt functions, the gross income derived therefrom would be from conduct of unrelated trade or business."

The ARC, through its plasma activities, is engaged in a trade or business regularly carried on and generating substantial revenues. This plasma business is directly competitive with commercial industry. Because of its favored tax status, the ARC has a competitive advantage Congress has judged to be unfair. By every measure used by the courts and the Internal Revenue Service, the ARC's plasma business is not substantially related to the purposes which form the basis of the ARC's exemption under Section 501(c)(3) of the Code. Accordingly, under Code Section 513, those revenues are taxable.

VII.

THE ARC's BLOOD SERVICES DIVISION'S PROFITS MUST BE TAXED AS UNRELATED BUSINESS INCOME IN ORDER TO RELIEVE THE INDUSTRY FROM UNFAIR COMPETITION

The ARC should pay tax on the revenues generated by its plasma business. The ARC is a 501(c)(3) organization engaged in regularly selling and distributing nationwide a comprehensive line of plasma derived pharmaceutical products. Its activities include recovery of salvage plasma, production of fresh frozen plasma from whole blood, plasmapheresis, marketing plasma derivatives, distribution of chemical reagents and typing sera, and sales of excess or unneeded product to plasma brokers for export. The ARC has frankly expressed its desire to capture a substantial market share, or even a monopoly, in these products. A vast organization carries on these activities. Its products are comparable, if not identical, to those of the proprietary, tax-paying industry. The prices at which its products sell are below competitive proprietary industry's prices. Its customers are the same customers. Every sale made by the ARC is effectively a sale lost to a tax-paying industry. Likewise, every such sale is effectively a loss of tax revenues to the United States Treasury. This is the very situation Congress sought to foreclose when it adopted Sections 511 through 513: a tax exempt organization cannot generate revenues by engaging in business which competes with private industry unless it competes on a fair basis -- by paying tax. In reaching that judgment, Congress recognized that an organization which is able to price and sell a product without having any liability for federal income taxes is a formidable market force. Thus, under Sections 511 through 513, when a tax exempt organization operates an activity in a manner similar to a commercial business, the activity is competing unfairly with private enterprise, and has no substantial relationship to the organization's exempt purposes.

The German tax law embodies a concept similar to that contained in Sections 511 through 513. Under German law, tax exempt organizations which compete with taxable businesses beyond an "unavoidable" level must be taxed to avoid unfair competition. That philosophy has recently been applied to the German Red Cross in a decision that the various German states can tax the German Red Cross' plasma fractionation program in the same way as they tax commercial fractionators of plasma.

SUMMARY

The following key points are restated to emphasize the position of this paper:

- The ARC's Blood Services Division's revenues are not substantially related to the performance of its original tax exempt purpose.
- The ARC's pricing policies are intended to undermine the Plasmapheresis and Fractionation Industry by unfair pricing.
- The ARC's Alliance with Baxter Travenol substantially impacts the U.S. Plasma/Fractionation Industry.
- The ARC Intends to Take Over the U.S. Industry by Continued Expansion of its Blood Services Division into the Market Place.
- The ARC is Engaged in the Production of Active Income Producing Activities that are also Being Carried on by Taxable Businesses.
- The ARC's Blood Services Division's Profits Must be Taxed as Unrelated Business Income in Order to Relieve the Industry from Unfair Competition.

Judged by legislative history, case law, and the views of the Internal Revenue Service, expressed in both regulations and revenue rulings, the ARC is engaged in a "taxable commercial activity" competitive with private enterprise that is unrelated to its exempt purposes and is therefore taxable.

If you have any questions or if we can provide any additional information, please do not hesitate to call us. If you deem it appropriate, the undersigned, along with representatives of Alpha Therapeutic Corporation would be pleased to meet with you or your staff.

Respectfully submitted on behalf of
Alpha Therapeutic Corporation,

H Edward Matveld
H. Edward Matveld
Vice President, Controller & Treasurer

Edward Alexander Colton
Edward Alexander Colton
General Counsel

FOOTNOTES

1/ 33 Stat. 599 (1905), as amended; 36 U.S.C. Sections 1 *et seq*. (1952).

2/ 36 U.S.C. Section 3. Section 3 contains the entire statement of the ARC'ss purposes.

3/ 61 Stat. 80 (1947).

4/ 67 Stat. 178 (1953).

5/ Address of Dr. Frank Stanton to the American National Red Cross annual convention (May 18, 1981). The address makes no reference to the tax-exempt purposes of the Red Cross or the relationship of the new program to those purposes.

6/ All financial information is from the annual reports of the American Red Cross.

7/ Sanford Bernstein & Co., Inc., Research Report, "Developments in the Plasma Fractions Market," P.27, Table 24 (using the 1977 column). LeConey, "Who Needs Plasma? Part I," *Plasma Quarterly* 93, Table 4 (September 1980).

8/ Wick, quoted in Summary Transcript: Committee on Plasma Fractionation Facility Study, November 11, 1976.

9/ Treas. Reg. Section 1.501(c)(3)-1(b)

10/ *See* I.R.C. Section 513(a); *Hope School v. United States*, 612 F.2d at 301; Rev. Rul. 79-360, 1979-2 C.B. 236, 237 (health club run by youth organization).

11/ Treas. Reg. Section 1.513-1(d)(2).

12/ *Ibid*.

13/ Treas. Reg. Section 1.513-1(d)(3).

14/ Treas. Reg. Section 1.513-1(d)(4)(ii).

EAC:2588L

Chairman PICKLE. Now Mr. Asher.

STATEMENT OF THOMAS M. ASHER, PH.D., CHAIRMAN OF THE BOARD, HEMACARE CORP.

Mr. ASHER. Thank you, Mr. Chairman.

I am here mainly to appeal to the committee to utilize its formidable investigative powers and examine the operation of the ARC blood program. I am not talking about all the Red Cross charitable activities but only the blood program.

From the fragmentary information that has been available to me as a small businessman and a typical citizen, it is clear that the Red Cross has been engaged in an increasing effort since 1972 to monopolize the U.S. blood resources in their entirety.

Their continued success in this, as evidenced by some of the financial figures that Mr. Matveld presented here has led to harm to legitimate tax-paying businesses like mine; a loss of tax revenues to the Government; and has accelerated an encroachment into other medically related businesses which I think, if continued, will result in more harm to more businesses and more loss of tax revenues to the Government.

In 1972, and every year since, the board of governors of the Red Cross have stated their intent to provide the total blood supply to the United States. Originally, of course, the Red Cross and other community blood banks performed a major social function by being able to convince fellow citizens to put an arm out and let a needle go into it to help their sick fellow citizens. It was a very admirable thing to do, but it has gotten far afield from those days.

Right now, I would say the blood program is out of control. I think it is wildly trying to satisfy a voracious appetite, I guess in a way not unlike a teenager raiding the family refrigerator.

One obvious area is the pharmaceutical business such as plasma derivatives which are classified as such by the Federal Government. They are manufactured and are considered pharmaceuticals in every country in the world. The ARC is both manufacturing and selling these.

The ARC is practicing medicine. They actually are performing therapeutic services—that is, hemapheresis—in half of their blood centers. They also are providing an interoperative blood-salvaging service in hospital surgeries in direct competition to surgical staffs. They are directly competing with physicians' practice of medicine in these two particular activities. I am a little surprised that the medical profession hasn't become concerned about this.

The ARC is actively planning to procure humans exclusively. They are now storing human bone marrow. These are all admirable activities, but once again, the emphasis is on being the exclusive supplier having an advantage over other organizations or individuals.

They have manufactured diagnostic agents, such as HLA typing serums. They have distributed diagnostics manufactured by other people, in the same way as the commercial distributors to hospitals. I am surprised they have not distributed Band-Aids, yet.

They are currently selling some difficult-to-procure blood components in direct competition to me, or perhaps I should say, I am in direct competition to them. I only have fragmentary information because it has been denied me even though I am a member of the public, and the tne ARC is supposed to be an open organization. They appear to be subsidizing the cost of these hard-to-procure blood components with their ordinary products—that is, packed red cells—to keep the price of the hard-to-procure blood compenents down and to make it exceptionally difficult for someone like myself to compete. I don't know this for a fact because, once again, I have been denied financial information.

They act like a business; they perform in an identical fashion as a business. They pay commissions to their sales force. They market with similar advertising literature to their customer hospitals. They price their product at the market. The market goes up, their prices go up. The market goes down, their prices go down. If they were providing these pharmaceuticals at cost, the prices would remain constant. The cost of living doesn't change that much.

I think they have four major unfair advantages in the blood industry, particularly the derivatives, but also in other industries upon which they are encroaching. Their raw material is free. Their blood donors are not paid; they receive nothing. Of course, this is the philosophic issue and they certainly are free to practice their beliefs, but their donors don't even receive a reduction in charge or don't receive credits when they need blood. They pay hard cash for it.

Their advertising is free. It has been estimated that they get over $20 million a year in free advertising. Much of their labor is free in the form of volunteers.

Then, lastly, they pay no taxes. Interestingly enough, they would be rated as No. 473 in the Forbes 500 based on gross revenues. However, they would rank No. 50 in the Forbes 500 based on percentage profit on sales. You may wonder how a business like mine could even begin to compete, and I think the only reason businesses can is that the Red Cross is willing to charge market prices instead of its cost. Its profits have to be enormous.

Finally, all I am requesting is that the GAO identify the ARC blood program costs to see how their fees are determined. Does the blood program support the chapter activities in little ways such as paying rent sharing personnel and the like?

An indepth audit is required. I am under the impression that the whole basis of this committee's investigation is to reexamine the concept of fair taxation. I was under the impression that taxation is supposed to be neutral to competitive trade and that a disproportionate assessment of taxes truly infringes on the freedom to compete.

I think by not charging taxes to a not-for-profit, or any organization who is acting like a business and competing like a business, gives them a freedom to monopolize; and once we have a monopoly, we no longer have competition or innovation. The basic requirement in the charters of charitable organizations is public service which also is easily forgotten by the lethergy that a monopoly encourages.

Thank you.

Chairman Pickle. Thank you, Mr. Asher.

[The statement of Mr. Asher follows:]

June 26, 1987

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Building
Washington, D.C. 20515

RE: Unfair Competition of American Red Cross Blood Program and Request for GAO Audit

Dear Mr. Chairman:

I am here today to appeal to the subcommittee to utilize its investigative tools to fully examine the unfair competitive business practices of the American Red Cross (ARC) Blood Program and, in addition, to see that said program pays it's fair share of income taxes on the profit it makes on those portions of the blood program which are beyond that of a tax exempt organization's charter.

There exists a scenario of events and actions by the American Red Cross Blood Program starting in 1972 which would indicate a continuing and concerted effort to monopolize the entire blood resources of this nation and, more recently, to spread out into many other aspects of medicine. Annually, since 1972, the Board of Governors of the Red Cross have announced in the minutes of its annual meeting this continuing desire to be responsible for "the total blood resources" and, more recently, preventative public health aspects of the United States. The ARC, which procures about 55% of the fresh blood in the United States, differs from other community blood banks in that its activities have gone far beyond that of community blood banks. Conventionally, the major social value of blood banks is to appeal to individuals to donate their blood for the wellbeing of their fellow man. That activity, historically, is a charitable one and has never had significant competition from for profit institutions. However, the ARC blood program has entered into many conventional business activities in direct competition to tax paying organizations and competes unfairly in a variety of fields including, but certainly not limited to, the following:

1. Sales of manufactured derivatives (i.e., pharmaceuticals) from human plasma (competing against plasma fractionators such as Alpha Therapeutics who is also testifying today).

2. Engaging in the practice of medicine by performing therapeutic hemapheresis procedures on patients and harvesting and reinfusing shed blood during surgeries in hospitals (thus competing against physicians, nurses, technicians, hospitals, etc.).

3. Procuring human organs, storing and selling same to hospitals and patients.

4. Manufacturing diagnostic reagents such as HLA typing reagents (thus competing against manufacturers of diagnostic and laboratory reagents).

5. Selling certain difficult-to-procure blood products at less than cost by subsidizing these costs with small increases in their large volume blood products (specifically, competing with my organization).

These have been performed in a fashion indistinguishable from that of conventional businesses. For instance, their sales force which markets plasma derivatives receives "commissions based on performance". The sales price of these products closely follow that of the market. When the market goes up, so does the price. When the market goes down, so does the price. They usually are the lowest bidder.

The unfair advantages the ARC Blood Program has over tax paying business include the following:

1. Their raw material is free. Donors are not paid nor do they receive any credits or reduction in blood charges if they ever need blood.

2. Their advertising is freely gifted by the advertising council.

3. Much of their labor is free in the form of volunteers.

4. They pay no taxes.

One might wonder how a business could even begin to compete against the ARC under such disadvantages. A logical explanation is that the ARC Blood Program does not base its fees on its costs as is required for tax-exempt organizations but rather establishes fees on "market", hence, deriving significant "revenues in excess of expenses."

It has been impossible for the public to obtain a meaningful, financial statement from the Red Cross and many, if not all my suppositions, are impossible for me to document. While audits have been performed by the Department of Defence, on the face of it they appear superficial and usually done without the purpose of clearly identifying costs which might have been placed on the blood program though conceivably supporting the Chapter activities such as flood and disaster relief, loans to servicemen, cardiac training programs, etc. I would like to distinguish between the Chapter programs and the Blood Program. There appears to be no cause to assume that the Chapter programs are operating outside their tax-exempt status. Only the blood program has business activities in the fields where legitimate businesses are presently operating, operates identically to conventional businesses and possess the above listed unfair advantages needs scrutiny.

I am asking the subcommittee to utilize the GAO to perform a full and in-depth audit to identify the ARC Blood Program activities which are identical to ordinary businesses and to re-examine the basic concept that taxes should be "neutral to competitive trade" (i.e., like businesses should be taxed in like fashions). Certainly, the disproportionate assessment of taxes truly infringes upon the freedom to compete. I hope the Committee will agree that freedom to compete is what produces the most efficient and innovative operations which, in turn, best serve the consumer and the entire well-being of the society.

Respectfully submitted,

Thomas M. Asher, Ph.D.
Chairman of the Board
HemaCare Corporation
4954 Van Nuys Boulevard
Sherman Oaks, California 91403

Chairman **Pickle**. Now it would appear that we have some difference of opinion on this panel.

Dr. Barker, you stated that the Red Cross does pay some UBIT but it is very small as a part of your overall operations. If I understand, you say it was point 005?

Dr. **Barker**. Five one-hundreths of 1 percent.

Chairman **Pickle**. Five one-thousandths percent.

Dr. **Barker**. Yes.

Chairman **Pickle**. So it is insignificant. That means, then, that the income you have in the field of blood, blood plasma, is being considered related and therefore you pay no taxes on that.

Dr. **Barker**. Right.

Chairman **Pickle**. Now, if you derive most of your revenue from blood services—and I understand your testimony says you get 77 percent of your revenue from that category—and about 50 percent of your total expenses relate to blood services, I want to ask you, which of your blood services processing activities compete with proprietary firms? All of them or part of them, or what? What part is in competition with the proprietary firms? Why isn't it considered unrelated business income?

Dr. **Barker**. Mr. Chairman, first I would slightly modify the figure. Our blood services revenue account for roughly 60 percent of total Red Cross revenue and roughly 40 percent comes from philanthropy, endowment income and other sources.

We have been in the blood services field since we started our Plasma for Britain program before World War II. In fact, we were collecting from volunteer donors some years before that.

With regard to competition, there was a period when there were a large number of commercial blood banks in this country. They largely disappeared as a result of the national blood policy promulgated in 1973 which called for an all-volunteer donor system. So there is very little competition with what I would call the traditional commercial blood banks.

Chairman **Pickle**. As I understand it, in general, the IRS has ruled that where you take blood from individuals through the Red Cross programs and then you redistribute it to individuals who need blood, there is no processing involved, there is no unrelated activity, and the revenue is not subject to UBIT. I assume if it is blood or plasma that is taken and then is sold to the public or transferred to other activities where there is income generated, that that would be subject to the UBIT. Apparently it is not, however.

Am I misunderstanding my analysis of what IRS has ruled?

Dr. **Barker**. You are correct, there is substantial income for all aspects of our blood services. We operate them on a cost-recovery basis. That is to say, obviously the total revenue with an excess that we require for working capital and equipment and buildings and so forth, basically balances the total expenses. It is a wash. All of our blood services, including the plasma derivatives, which my colleagues are associated with, do generate revenue which offsets the total costs of providing the services.

Chairman **Pickle**. If you do generate revenue in a portion of the blood plasma processing that you handle, I am asking, why wouldn't that be subject to the UBIT?

Dr. **Barker**. Our plasma fractions actually are where we started our services program. That is why it was called the Plasma for Britain program in 1939. This has always been viewed as a part of the total volunteer donor program.

In World War II, in fact, the plasma part was really the most important part.

Chairman **Pickle**. It is a volunteer part of the program, even though when individuals donate you take the plasma and process it for sale?

Dr. **Barker**. We have extensive costs for all of our blood service elements, the red cells, the plasma; we cannot do this without engendering costs. They are very substantial. That is why we have substantial revenues.

Chairman **Pickle**. Mr. Asher, Mr. Matveld, would you like to comment? Do you view that the ARC is in competition with you when they sell plasma to other agencies or organizations?

Mr. **Asher**. As far as I am concerned, I face it daily. In my very small way, I am in competition, but this gentleman to my left is in massive competition.

Chairman **Pickle**. Do you have your own business?

Mr. **Asher**. Yes.

Chairman **Pickle**. Where is your business?

Mr. **Asher**. In Los Angeles.

Chairman **Pickle**. Do you represent an association?

Mr. **Matveld**. No, I represent our firm.

Chairman **Pickle**. A firm.

Mr. **Matveld**. Yes. I do differ sharply with Dr. Barker on his assumptions?

We are in day-to-day competition. The ARC does sell plasma to brokers. The American Red Cross also takes plasma, as we do, and fractionates into its components and sells it, sells the final products.

Now, I believe before you were referring to revenue ruling 78-145, and your statement was accurate that the sale of plasma to commercial laboratories by an exempt blood bank engaged in collecting and maintaining blood products for use by hospitals is not an unrelated trade or business where the blood bank sells either byproduct plasma from which red cells have been removed for use by hospitals or plasma salvage from whole blood nearing its shelf life. That ruling does not address taking the plasma to its final product.

Chairman **Pickle**. Mr. Barker, do you manufacture and sell plasma derivatives—and I understand from your testimony that you do—is such manufacture and sale done on a joint venture basis or through any kind of a partnership venture with some for-profit organizations?

Dr. **Barker**. We don't have any joint venture arrangements. We do have our plasma fractionated, for the most part, by pharmaceutical companies. A great deal of this is done by Hyland Laboratories. We don't sell the plasma to these entities. We maintain control of it.

Basically, we contract with them for the fractionation and we require the return of the fractionated plasma derivatives to our regions, which, in turn, distribute them to their hospitals.

Chairman **Pickle**. I don't think there is any question but that the blood service program of the Red Cross serves a public interest. It is one of the great organizations of America, and the nation is indebted to you, and the purpose of this committee is not to cause difficulties for your operation, but to encourage you and to help you.

I take it that whatever processing you do of blood plasma, you get the additional income and you justify it on the basis that you are serving the public, and you need the extra income, and it should not be called an unrelated trade or business. That is a question that we are plagued with, so to speak, in this committee.

I can see why you would be concerned whether the sale or transfer of plasma is in competition with other firms.

The real question in my mind is should you be subject to UBIT, not so much that we want to curtail your operation, but to do what is fair. That is the issue that concerns me.

Thank you.

I think I understand the practice.

Mr. Flippo, do you have any questions?

Mr. **Flippo**. No questions.

Chairman **Pickle**. We thank you. You have posed a difficult problem for us, because we have got to consider what should be taxed and also what is in the public interest. We appreciate your testimony.

[The following was subsequently received:]

AUG 06 1987

American Red Cross

National Headquarters
Washington, DC 20006

August 3, 1987

Congressman J. J. Pickle
Chairman, Oversight Subcommittee
Committee on Ways and Means
United States House of Representatives
242 Cannon House Office Building
Washington, DC 20515

Re: Unrelated Business Income Tax Hearings:
Response to Treasury Recommendations

Dear Mr. Chairman:

The American Red Cross appreciated the opportunity to testify before the Oversight Subcommittee during its recent hearings on the unrelated business income tax. We believe that the questions of tax policy and tax administration that were raised during the course of the hearings are significant ones. We agree that the law in this area can be revised and improved, but we believe that the process should be a careful one, taking full account of the broad social interests that are potentially at stake.

We have considered the recommendations and suggestions set forth in the statement of O. Donaldson Chapoton, Deputy Assistant Treasury Secretary for Tax Policy, and we believe that the Treasury's position in general is balanced and constructive. Our views on certain of the Treasury's specific proposals for revisions to the unrelated business income tax are set forth below.

The Substantially Related Standard

The Treasury statement concludes that the "substantially related" standard that is applied under present law to determine which activities of charitable or educational organizations are exempt from Federal income tax should be preserved. We believe that this judgment is correct, and that it is a very important one. We believe that the relatedness standard does what the unrelated business income tax was intended to do: it identifies, and provides an exemption from tax for, those activities that are actually important to the promotion of charitable or educational purposes, while taxing activities that do not contribute meaningfully to the accomplishment of exempt objectives.

No one suggested during the course of the Subcommittee's hearings any alternative to the relatedness standard that we believe would be either practical or desirable. Certainly we believe that any standard involving judgments as to competitive effects or commercial availability would be fundamentally inconsistent with the long-standing view of both the Congress and the Treasury that activities which promote charitable or educational objectives in a significant way should be exempt from tax, without reference to transitory market circumstances. Moreover, we believe that any standard requiring an analysis of commercial or competitive factors would be more subjective, more subject to change over time, and generally much more difficult to administer than the present standard.

We agree with the Treasury, therefore, that the relatedness standard plays an important role in the unrelated business income tax, and that it should be preserved.

We accept the Treasury's conclusion that compliance with the unrelated business income tax would be improved by expanded disclosure requirements. The Red Cross would therefore support changes and additions to the Form 990, perhaps including a requirement that certain kinds of revenue-generating activities not reported on the Form 990-T be described.

Passive Income

The Treasury recommends preservation of the unrelated business income tax exemption for investment income in the case of public charities such as the Red Cross. We strongly support this position, and urge the Subcommittee to exercise particular care with respect to this very important issue.

The Red Cross has been able over the years to build a very substantial endowment, specifically because so many people have recognized that an endowment is critical to our ability to respond to large-scale natural disasters and to adapt quickly to national health care emergencies such as AIDS. Our endowment is the result of numberless bequests and contributions -- many in relatively small amounts -- from individuals who recognized that an organization like the Red Cross cannot simply hope to fund its activities on a current basis. Maintaining an endowment is a critical element of our operations, and a tax on the income from that endowment would be essentially a tax on our operations. We do not believe that the Congress intends such a result, and we urge the Subcommittee to accept the Treasury's recommendation that the exemption for investment income of public charities be preserved.

Taxable Subsidiaries

Under present law, payments of deductible items such as interest, royalties, rent, or annuities from a "controlled" subsidiary are taxed upon receipt by an exempt parent. The purpose of this rule is to prevent the tax-free flow of money from a subsidiary that carries on what should be taxable activities. The Treasury proposes that the control definition be expanded to include a 50% rather than an 80% ownership test; that the test be applied by reference to value as well as voting power; and that ownership attribution rules be enacted.

We believe that applying the control test to the value of the stock interest in a subsidiary (thus eliminating the present law option of avoiding "control" through creation of a second class of stock) and adding ownership attribution rules are reasonable measures to address what we agree has been a problem in this area. Accordingly, we support the Treasury proposal in these respects.

In addition, the Treasury Department proposes the adoption of rules under which the activities of taxable subsidiaries would be aggregated with the activities of an exempt parent for purposes of determining whether the parent's activities are primarily charitable. Where a taxable business is not only separately incorporated but also separately managed, we find no reason to assume that the attention and efforts of the exempt organization are likely to be diverted to the business of the subsidiary. In such a case, we do not believe that there is any basis to treat such a business as if its activities were conducted directly by the exempt parent.

However, in circumstances where officers and directors of the exempt parent are actually involved in the day-to-day activities of a subsidiary, so that resources of the exempt parent are in fact diverted to the taxable business, it is our understanding that the Internal Revenue Service now requires aggregation. We would support a statutory or regulatory change designed to formalize that administrative policy.

Partnerships

The Treasury makes two proposals dealing with the participation of exempt organizations in joint ventures or partnerships. First, the Treasury suggests that because deductions and other tax benefits can be shifted from tax-exempt to taxable partners, the rules governing partnership allocations between tax-exempt and taxable entities should be revised. The Treasury statement includes an example of the kind of shifting of tax benefits with which it is concerned. We believe, however, that the partnership arrangement that the Treasury describes is quite common in a broad range of partnerships in which the partners have differing tax characteristics or different marginal tax rates. To the extent that there is a problem, therefore, the problem is a broad one, and the role of tax-exempt organizations is relatively minor.

We have been advised that the real potential for abuse in this area has been addressed by earlier legislative activity, and by the recently issued regulations under section 704 of the Internal Revenue Code. To the extent that any concerns remain, however, we do not believe that it would be appropriate, or even that it would be feasible, to try to address them solely in the context of tax-exempt organization arrangements.

The Treasury also indicates concern about the use of partnerships or joint ventures to accomplish exempt purposes, and suggests that under certain circumstances the exempt organization's share of income from a partnership with a taxable partner should be subject to the unrelated business income tax. In general, however, we believe that charitable organizations enter into partnership arrangements to accomplish exempt purposes only where there is some valid reason to do so -- some reason why the charity cannot financially or practically pursue the exempt activity on its own. When a charitable organization does enter into a partnership or joint venture, it is subject under present law to strict tax rules and other rules that prohibit use of the charity's funds or resources to benefit individuals or other private interests, and that require the charity to ensure that taxable partners receive no greater share of partnership profits than is necessary to secure their participation in the venture.

The rules of present law in this respect are apparently very clear, and they seem to be very sensible. We agree with the Treasury's view that, if such rules are violated, imposition of tax rather than loss of exempt status should be the remedy, and we would support a change in the statute to allow the IRS to respond in this way. We do not agree, however, that the use of partnership arrangements in connection with exempt activities is a subject of abuse. We would certainly not support any general prohibition or restriction on participation in partnerships for exempt purposes.

There are a number of other recommendations included in the Treasury's statement that are not applicable to any of the current or likely activities of the Red Cross, and that we have no real basis to evaluate. For the most part, these proposals appear to be reasonable, and we certainly support in principle the adoption of measures designed to respond directly to areas of perceived abuse.

I appreciate your consideration of our views, and I assure you that the American Red Cross is prepared to cooperate with the Congress and the Treasury in any reasonable revision of the unrelated business income tax.

Yours truly,

Lewellys F. Barker

Lewellys F. Barker
Senior Vice President
for Development

RECEIVED

SEP 9 1987

Ways and Means
Subcommittee on Oversight

American Red Cross

National He[illegible]
Washington, DC 20006

September 1, 1987

Re: Unrelated Business Income Tax Hearings:
American Red Cross Blood Services

Dear Mr. Chairman:

On August 3, 1987, I wrote to you on behalf of the American Red Cross to set forth our views on several of the U.S. Treasury Department's proposals regarding unrelated business income tax. I am writing to you again to provide additional information about our blood services operations. You will recall that this aspect of the Red Cross was the subject of discussion during the hearings which you chaired on June 26, 1987. Because of the importance and the complexity of the subject matter, it is appropriate to take this opportunity to review the role of the American Red Cross in the national blood system and the methods we use, as a not-for-profit organization, to finance the delivery of blood services to the American public. In providing this information, we will also respond to allegations made during the hearings by H. Edward Matveld, Vice President of Alpha Therapeutic Corporation of Los Angeles, California, a subsidiary of Green Cross of Japan and by Thomas M. Asher, Chairman of the Board of HemaCare Corporation of Sherman Oaks, California.

The Red Cross has been at the center of the nation's blood services system since World War II. Throughout our history of involvement in the American blood system, we have treated blood and blood products not as commodities or as opportunities for profit, but as a critical national resource made available through voluntary donation to meet the medical needs of our citizens. Scientific and medical advances, many of them aided by Red Cross research, have made it possible for the components and derivatives of human blood to be used in a widening range of therapeutic applications. These advances have made the American blood system more complex. They have not made the commitment of the American Red Cross to an all-volunteer blood supply less appropriate.

In the course of the recent hearings, you heard from representatives of companies engaged in the business of selling blood products for profit. They urged you to change the laws that define unrelated business income so that some Red Cross activities will become more costly. They asked this, not because such activities have become less important to the nation or are inappropriate for charitable organizations, but simply because it would allow them to more easily derive a profit from their sale of blood products.

We do not believe that the availability of the full range of blood products in this country should depend completely on the marketplace. Yet this is what is being asked by a few companies engaged in the marketing of blood products and more generally by those who argue that competition or commercial availability should be the determining factor in application of the unrelated business income tax.

As a nation, we rely on our charitable sector for a very wide range of benefits and protections. We should not let the operation of these organizations be undermined because of transitory market circumstances, and we should not let concerns about competition lead to the erosion of national assets such as our voluntary blood donation tradition.

FINANCING AMERICAN RED CROSS BLOOD SERVICES

The American Red Cross blood services program began as a response to Great Britain's request for plasma to meet the medical needs of its forces in the early days of World War II -- and later to meet the needs of American soldiers and sailors. The civilian blood services program was initiated by the organization's Board of Governors on June 8, 1947. Since then, the Board has modified the financial policies and procedures for the program several times to accommodate changing circumstances. Over a period of twenty years, the financial base of the program has changed from philanthropic contributions to fees charged at the local level to hospitals that utilize program services.

Under early policies and procedures, the American Red Cross used philanthropic contributions for almost 80% of the financial support of blood service operations. The strain of supporting the program from limited philanthropic contributions prompted the Board of Governors to place limits on the amount of national sector support and in November, 1953 to authorize regional blood centers to negotiate agreements whereby a portion of the program's costs would be met by the hospitals that used their services.

On March 20, 1961, the Board authorized regional blood programs to enter into agreements with hospitals for reimbursement of the operating costs of collecting, processing, and distributing blood used by civilian hospitals. This method of financing American Red Cross blood services proved to be successful and the level of financial support of blood centers by the national sector was steadily reduced as local resources increased. On July 1, 1970 the national subsidy to regional blood centers was eliminated.

The Board of Governors adopted a policy at its June 3, 1973 meeting that it was desirable for the blood program to be financially self-sustaining and that adequate controls be maintained so that revenue from the program not exceed accepted costs. Because blood program income and expenditures had continued to be subject to fluctuations often beyond the control of the Red Cross, a reserve fund was established to meet emergency needs, revenue and expense fluctuations, and future equipment and capital improvement requirements.

On May 22, 1977 the Board of Governors adopted the following resolution:

> "VOTED: The Board of Governors affirms that it is desirable for the Red Cross Blood Program to achieve and maintain financially self-sustaining status, with adequate controls to assure, in recognition of the humanitarian purposes of the program, that public support for and revenues derived from the program, do not exceed financial requirements of the program. Such financial requirements properly include, but are not limited to, provision for adequate working capital, acquisition of necessary capital assets, appropriate reserves for depreciation, research and development, and sufficient reserves to assure the financial stability of the program.

As this historical overview makes clear, the American Red cross has used its philantrhopic resources to initiate and support an important health program. As the blood services program developed, it became possible for it to generate its own support through agreements with the hospitals that use its products. The American Red Cross monitors the performance of its regional blood centers closely to assure that their financial arrangements are adequate to meet the blood needs of the American people and that funds generated by the blood services program are used to support only the blood program and closely allied research and development activities.

RESPONSE TO ALLEGATIONS RE AMERICAN RED CROSS FINANCIAL PRACTICES

During the Subcommittee hearings on June 26, 1987, representatives of two commercial blood organizations made several unfounded allegations regarding the financing of American Red Cross blood services.

The allegation was made that the American Red Cross sells blood products below cost. In fact, it is Red Cross policy not to sell its products below cost. Red Cross blood services regions have been advised specifically that "it is essential that all products and services provide for full cost recovery." Compliance with this policy is monitored closely.

The allegation was made that the raw material used by the American Red Cross is free and, by implication, provides an unwarranted competitive advantage. The raw material referred to is human blood. The American Red Cross is committed to maintaining a comprehensive blood system that is based on voluntarily donated blood. It is not surprising that representatives of organizations that buy blood components and sell blood products for profit would find this commitment difficult to understand. Nonetheless, the idea that parts of the human body should not be bought and sold in the marketplace has a respected place in the ethical tradition of our society.

The allegation was made that American Red Cross financial statements are not meaningful. On the contrary, the Red Cross takes pride in its financial disclosure to the American public. Distribution of its annual reports goes far beyond what would be the norm for profit making corporations. Our financial statements conform to the principles prescribed by the Financial Accounting Standards Board. Federal statutes require that the Red Cross report income and expense to the Department of Defense annually. This report is then audited by the U.S. Army Audit Agency and forwarded to Congress. In addition, the Red Cross engages a nationally recognized firm of independent certified public accountants, Deloitte Haskins & Sells, to audit the combined financial statements that it makes available to the American public. Every blood center is required to engage a certified or other competent public accountant each year, and resulting audits and opinions are included in the combined statements and overall opinion and review by Deloitte Haskins & Sells.

The allegation was made that the American Red Cross uses its blood program to provide subsidies for the non-blood activities of Red Cross chapters. However, the Board of Governors policy of May 22, 1977 requires that income not exceed the anticipated or actual financial requirements of blood services. Policies and procedures are in place to separately record blood services assets, liabilities, and fund balances. These segregated records are audited each year in each location by a certified or other competent public accountant on a mandatory basis. The financial report clearly shows a segregation of funds with net assets shown to be designated by the Board for blood service operations. Strict internal controls are in place to make sure that payments to chapters are only for appropriate and authorized expenses.

The allegation was made that the financial performance of the American Red Cross blood program is in excess of what is required. The May 22, 1977 policy identifies specific financial requirements for the blood program and mandates against the generation of more income than is needed to support and maintain the program. A blood program that includes 56 regional blood centers and accounts for half the nations blood supply necessarily requires significant reserves for capital asset replacement and improvement, working capital, and to respond to unforeseen requirements such as the rapid implementation of the most advanced technology for the detection of transmissible diseases such as AIDS.

AMERICAN RED CROSS PLASMA OPERATIONS

The American blood system, of which the American Red Cross is a significant part, includes a variety of organizations engaged in the collection and processing of blood and the production and distribution of blood components and blood derivatives. Human blood is a mixture of specialized cells suspended in plasma, which itself contains proteins, nutrients, salts and hormones. In blood banking terminology, components are blood products such as blood cells and plasma that can be separated from whole blood. Derivatives are products derived from the chemical fractionation of plasma.

Blood banks which supply blood components to meet community needs often sell their excess plasma to commercial organizations for fractionation into derivatives which are sold for profit. In contrast, the American Red Cross processes plasma into derivative products which are then distributed in the communities it serves. In the year ending June 30, 1987, the Red Cross system recovered and fractionated under contract approximately one million liters of plasma into therapeutic products for the prevention and treatment of several medical conditions. Products, including Albumin, Plasma Protein Fraction, Antihemophilic Factor (Factor VIII), Factor IX Complex and immune globulins are packaged with distinctive Red Cross labeling which states "This product is derived from blood collected from volunteer donors by the American Red Cross Blood Services. The cost of processing, testing and packaging was paid by the American Red Cross Blood Services."

In the current operating year, the American Red Cross will serve the needs of approximately 500,000 patients requiring Albumin and Plasma Protein Fraction and approximately 5,000 of the nation's 20,000 hemophiliacs requiring Antihemophilic Factor. Red Cross will also introduce two new products -- a patented Factor IX product which was developed by scientists in Red Cross laboratories for clinical use with hemophiliac patients and Antithrombin III for clinical use in prevention and treatment of thrombosis in patients with congenital deficiency.

In contrast to the Red Cross, most other blood banks sell plasma recovered from whole blood donations to U.S. commercial fractionators at current market prices. These commercial fractionators retain all title to the finished products derived from volunteer plasma and distribute it in the United States, Japan, Western Europe and other overseas markets. It is possible that the American Red Cross could earn more money by selling its excess plasma to commercial fractionators. It does not do so because it is not a profit oriented business, but rather a human service organization with a responsibility to meet the full range of blood product needs in the communities it serves. In contrast with commercial fractionators which derive the majority of their revenue from the sale of blood derivatives on overseas markets, the Red Cross distributes its products within the United States.

The major industry revenue generator is Albumin. Only one of the four major U.S. fractionators distributes the majority of its Albumin in the United States. In contrast, Red Cross distributes its Albumin to hospitals and clinics in the United States, except for small amounts distributed to our sister society, the Canadian Red Cross.

The Red Cross, due to its commitment to serve first the needs of the American public, does not distribute products manufactured from U.S. volunteer plasma in overseas markets and, therefore, does not reap financial gain from the high overseas prices. The average selling price for one international unit of Factor VIII in the United States was 9.5 cents; prices for Factor VIII products in Europe and Japan were three times that. Similar disparities exist for other derivatives. Despite allegations to the contrary, the American Red Cross does not behave as a business if that term means to behave in a profit-maximizing manner. The Red Cross consciously and continually foregoes revenue opportunities in order to maintain its commitment to provide a full range of blood components and derivatives within the communities it serves.

RESPONSE TO ALLEGATIONS RE AMERICAN RED CROSS PLASMA OPERATIONS

The allegation was made that Red Cross pricing policies are intended to undermine the plasmapheresis and fractionation industry by unfair price competition supported by Red Cross tax exempt status. While it is true that Red Cross will never be and should not be a market leader in terms of price increases, it is not true that we "attempted to increase market share by reducing prices below those charged by for-profit competitors." A review of competitive bid prices awarded in the last six months reveals that commercial manufacturers have significantly underbid Red Cross on numerous contracts and have succeeded in gaining considerable Red Cross business.

The allegation was made that the Red Cross contract fractionation agreement with Baxter Travenol is not consistent with its tax exempt status. The Red Cross does not own a fractionation facility and it has contracted with both not-for-profit and commercial fractionators to fractionate its plasma. Alpha Therapeutics follows the same practice and has recently contracted to provide fractionation services with Blood Centers of America, a consortium of independent volunteer blood banks.

The allegation was made that the "present ARC/Baxter Travenol relationships represents about 40% of the U.S. AHF market..." and that even a "modest increase in plasma in the U.S. market could quickly lead to an AHF market share of two-thirds." In fact, current Red Cross market share for AHF is much less (approximately 17%) and a 72% increase in Red Cross volume would be required before it would reach a two-thirds market share. Red Cross market share for Albumin has remained relatively constant over the past several years and could not increase substantially without similar increases in volume.

The allegation was made that the American Red Cross will continue expansion of Blood Services into the marketplace of for-profit companies, specifically the 350 plasma collection facilities which supply approximately 6 million liters of paid source plasma annually. The Alpha Therapeutics testimony states that "the majority of these centers are independently owned, providing plasma to the product fractionators." In fact, the majority of collection centers are owned by less than 30 corporations controlling over 90% of the paid plasma collection activities in the United States. Alpha is the largest U.S. operator of paid commercial donor centers.

The allegation was made that the American Red Cross won a large majority of a bid contract for supplying the Canadian Red Cross with Albumin and Antihemophilic Factor and noted that Baxter Travenol was not among the bidders. This is simply incorrect. The Red Cross did not receive the bid award and the contract was awarded to Baxter Travenol.

The allegation was made that Red Cross plasma activities are not substantially related to the purposes which form the basis of the Red Cross 501(c)(3) exemption because it makes further use of the plasma it collects from voluntary donors beyond what is necessary for disposition in its original state. However, current transfusion practice dictates that the safest and most efficacious product is to be used in the treatment of disease, trauma or congenital condition. Fresh frozen plasma for transfusion is not the safest, most efficacious product for the treatment of many conditions, such as hemophilia and immune deficiencies. It is very much within the mission and responsibility of the American Red Cross to help meet such needs by making full use of the voluntarily donated blood that is entrusted to us. To argue that the fractionation of plasma into a variety of products of therapeutic value to special patient populations is inappropriate for the American Red Cross is both erroneous and self-serving.

CONCLUSION

I regret that the complexity of the subject matter required such a lengthy letter. However, I felt it important to provide you with more complete comment on the issues raised on June 26, 1987 during the Oversight Subcommittee hearings. Nothing that was presented during those hearings suggests that the commitment of the American Red Cross to a comprehensive blood system based on voluntary donations is no longer important to the American people.

I appreciate your consideration of our views and commend you on the thoroughness and fairness of your oversight process.

Sincerely,

Lewellys F. Barker

Lewellys F. Barker, M.D.
Senior Vice President
for Development

Congressman J. J. Pickle
Chairman, Oversight Subcommittee
Committee on Ways and Means
United States House of Representatives
242 Cannon House Office Building
Washington, D.C. 20515

Alpha THERAPEUTIC CORPORATION®
5555 Valley Boulevard, Los Angeles, CA 90032
(800) 421-0008 (213) 225-2221 TWX: (910) 588-3253

December 23, 1987

Ms. Rusty Guritz
OVERSIGHT SUBCOMMITTEE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 Longworth House Office Bldg.
Washington, D.C. 20515

RE: DEPUTY ASSISTANT TREASURY SECRETARY O. DONALDSON CHAPOTON'S STATEMENT ON TAX POLICY BEFORE THE WAYS AND MEANS OVERSIGHT SUBCOMMITTEE HEARINGS ON UNRELATED BUSINESS INCOME TAX ON EXEMPT ORGANIZATIONS, JUNE 22, 1987

Dear Ms. Guritz:

The purpose of this paper is to bring to the attention of the honorable members of the Oversight Subcommittee, Alpha Therapeutic Corporation's comments that directly relate to Deputy Assistant Treasury Secretary O. Donaldson Chapoton's statement to the Subcommittee on June 22, 1987 regarding tax policy for Unrelated Business Income Tax on Exempt Organizations.

Our comments are outlined as follows:

1. The Allocation Issue

The computation of tax on unrelated business income is obviously directly connected to the ability to thoroughly allocate and apportion expenses that relate to the UBI. The system such as the regulations under Section 861 could be used to allocate expenses between tax exempt activities and taxable activities of an exempt organization. It is clear that what is needed is more detail in order to prohibit or preclude the tax exempt organization from disproportionately allocating expenses to taxable activities. The fragmention rule is barely acceptable and should be improved with respect to required detail. The burden of providing more detail and support should be placed on the tax exempt organization.

2. Substantial Relationship

Treasury does not propose to change the definition of "substantial relationship" but rather Treasury recommends a more detailed reporting requirement. In our judgment, we would suggest that the substantially related test be made stronger so that the exempt purpose is directly related to the activities, rather than substantially related. Although I do agree with more detailed reporting as a secondary means of improving enforcement and compliance, it appears unless there are more specifically defined methods for accomplishing the reporting details, the system may not work.

3. Controlled Subsidiaries

We agree with the Secretary's proposal that the definition of controlled subsidiaries should be those subsidiaries which are controlled by more than 50%, with respect to their value or voting power. The aggregation of activities of the exempt organization and its subsidiaries is acceptable. However, a serious question is raised as to why an exempt organization has to have controlled subsidiaries within its organizational structure. More specific commentary on this question needs to be addressed and an analysis and understanding of why exempt organizations organize controlled subsidiaries needs to be reviewed.

4. UBI Tax Rate

In order to provide a disincentive to tax exempt organizations from engaging in UBI activities, the UBI tax rate should be substantially increased so as to provide the inhibitor to the exempt organization from stepping over the line and potentially abusing its status by artificial allocations of expense to UBI. The increase in tax rate on the unrelated business income probably represents the biggest weapon that Congress could trigger in order to insure that the tax exempt organization does not attempt to create UBI and thus abuse its exempt status.

5. Passive Investment Income

Passive investment income, which merely results from receipt of interest and royalties, does not appear in our judgment to be a major item of concern for Congress. What should be focused in on is the activity of the exempt organization which led up to the passive investment income (i.e.; if a research activity created a patent which in turn resulted in royalties, then those royalties should be included in the tax exempt organization's UBI income.

6. The Definition of Research (as referenced in 5 above)

The definition of research should be tightly defined to avoid an end around run from the inclusion of the activities or benefits from research from the UBI. Thus, as a general rule, all research income should be excluded from tax exemption in order to insure that said income is properly taxed. This is especially true when dealing with purely commercial activities that do not merit exemption. These comments support the Secretary's comments. On the other hand, research activity which is funded by third parties and which results in a reimbursement for costs only (which never generates future income) should not be subject to tax and therefore should be excluded from UBI.

7. Joint Ventures and Partnerships

In our judgment, all joint ventures and partnerships which involve tax exempt organizations with entities which are for profit should be prohibited by law. The complexity of allocation of both income and expenses between a taxable entity and a non-taxable entity and the misappropriations and misallocations, whether intentional or unintentional, that can be made in this area constitute a potential major area of abuse.

8. A Specific Deduction

The specific deduction of $ 1,000 from UBI should be deleted and revoked. A $ 1,000 exclusion does not make any sense in light of the fact that unrelated business income is taxable. Since it is not a tax exempt activity, there should be no further benefit given to a taxable activity of the tax exempt organization.

9. Direct Competition

One of the key elements in determining whether or not a tax exempt organization should be taxed on certain parts of its functions is to determine whether or not those activities compete in any way, shape or form with a business which is not tax exempt. Of course, the magnitude and affect of that competition must be considered in that minor competition or immaterial competition should not be considered as a basis upon which the tax exempt organization should be taxed. However, (as in the case of the American Red Cross) where a significant portion of a marketplace is dominated and is in competition with other companies which are for profit, consideration should be given to automatically taxing the activities which compete directly or indirectly with taxable entities regardless of the exempt organization's status.

10. The Impact of Volunteer Workers on Tax Exempt Organization Activities

A tax exempt activity where organizations are exempt merely from the fact that there are volunteer workers performing services is unacceptable. This exclusion by definition is too narrow. Other considerations need to be taken into account in that the activity or function which the volunteers are performing may relate to an activity which competes with taxable entities. To the extent that the major portion of the activities performed by volunteers competes unfairly with taxable entities, the function should be subject to tax and included in the UBI. Care has to be provided, however, in that one does not become overzealous and tax proper and beneficial activities which are performed by volunteers. Therefore, the key in determining whether or not the activities should be taxable is whether or not that activity produces a product or results in the production of a product that eventually competes with taxable entities.

The above comments represent our general thoughts which relate to the statement by Mr. Chapoton on June 22, 1987 in his presentation before the Ways and Means Oversight Subcommittee on Unrelated Business Income Tax on Tax Exempt Organizations. There are perhaps other aspects or details that could be incorporated in the proposed changes that could tighten up the abuse that currently exists in the tax exempt organization area. However, a too detailed approach in attempting to capture all aspects of taxable functions of tax exempt organizations will probably result in a bill that cannot be passed because of its complexity and its compliance burden on tax exempt organizations.

If you have any questions or if we can provide any additional information, please do not hesitate to call us. If you deem it appropriate, the undersigned, along with representatives of Alpha Therapeutic Corporation, would be pleased to meet with you or your staff.

Respectfully submitted on behalf of
Alpha Therapeutic Corporation

H Edward Matveld

H. Edward Matveld
Vice President, Controller and Treasurer

Edward A. Colton

Edward A. Colton
General Counsel

EC:wh
2882/30

Chairman **Pickle**. Now the Chair is going to make a deviation here, if it is agreeable.

The American Association of Museums, represented by Mr. Willard Boyd—I understand Mr. Boyd may have a person or two with him.

I am going to ask also if I could include in this panel, Mrs. Laura Lee Blanton, if she is still here. I wish you would come forward.

I saw her leaving a few minutes ago and thought she had gone to catch a plane.

If Mr. Boyd and your group would take your positions, we will hear your testimony first and then we will hear from Mrs. Blanton.

Mr. Boyd, we are glad you are here.

I want to also say before I go to vote, we are pleased to have Mrs. Blanton with us.

She is from Houston, in my State, and she and her husband are great citizens of that city. I guess if we had a philanthropic pair in our State, it would be Jack and Mrs. Blanton.

We will be pleased to hear your testimony. I haven't read it, but I know it is going to be good. We do welcome you here. We are glad you are here.

I am going to excuse myself to go to the floor and vote. Mr. Flippo will assume the chair in the meantime.

Mr. Boyd?

STATEMENT OF WILLARD BOYD, PRESIDENT, FIELD MUSEUM OF NATURAL HISTORY, CHICAGO, IL, ON BEHALF OF THE AMERICAN ASSOCIATION OF MUSEUMS, ACCOMPANIED BY MARY SCHMIDT CAMPBELL, EXECUTIVE DIRECTOR, THE STUDIO MUSEUM IN HARLEM, NY; ROBERT J. McQUARIE, DIRECTOR, LITTLETON HISTORICAL MUSEUM, LITTLETON, CO.; AND BEVERLY BARSOOK, EXECUTIVE DIRECTOR, MUSEUM STORE ASSOCIATION, DOYLESTOWN, PA

Mr. **Boyd**. We very much appreciate the opportunity to underscore some of the points in our written testimony. There are three of us here representing the American Association of Museums, an organization of 2,000 art, history, science museums, historic houses, science and technology centers, aquariums, botanical gardens, arboretums, nature centers, zoos, children's museums, park museums and visitor centers.

We are diverse institutions with diverse collections, exhibits and budgets, but we share a common commitment, and that is to public education. It is estimated that over one half billion visits to museums are made each year. Museum doors are open to anyone and to everyone.

No membership test or fee is required to enter any one of these museums. Our Nation's nonprofit museums have a long tradition of scholarship, education and public service; justifying their tax-exempt status. Their contributions to our intellectual and cultural life, their capacity for inquiry and vision make them a vital factor in America's culture.

Museums have hard financial sledding. Museums that collect living animals and plants, such as zoos, aquariums and arboretums, must feed and care for those collections. Museums that collect inanimate objects must maintain high standards of care because of the uniqueness and, in many cases, perishable nature of those collections. We have 18 million specimens in the field museum constituting the biological data bank of the Western hemisphere.

I assure you that there is no profit in the preservation and exhibition of collections. Not many people want to undertake that.

In order to meet their public missions museums depend on a plurality of funding, each element of which is crucial and fragile. The written statement outlines the various types of income produced by museums and each museum activity is engaged in to support directly the museum's programs. Donations, memberships, admission fees, income from endowments and royalties and grants form the greatest percentage of income produced.

A lesser percentage, and we think no more than 35 percent, comes from what we call auxiliary activities, including museum shops, tours and food service. These auxiliary activities either exist as in the case of food and parking lots as direct services for visitors, or in the case of tours, museum shops and catalogue sales as an extension of the museum's educational mission. We believe that those auxiliary activities, because of their relatedness, offer little, if any, competition with profitmaking enterprises.

Museums tours are structured educational programs with lectures and curatorial guides. We supply the guide and lecturer, but go to commercial ventures to supply the tours themselves.

The single most important function of the museum shop, to our way of thinking, is to perpetuate the experience of the museum visit. The objects are carefully selected to relate to our collections or our exhibitions. The educational nature of the items is enhanced by descriptive materials that people can take home in order to further their information.

Catalog sales are somewhat different, as they are not limited to museum visitors, but they are intended to educate and to attract the buyer to the museum because we are trying to attract visitors to increase admission revenue. Limiting inventory in a museum shop to items related to the museum's purpose does limit their profitability and restrains our competition with commercial retailers. For the most part, our museum earnings are related earnings. Therefore, most of us are only filing 990 returns.

You have asked about unrelated museum income, and we have a survey which we would like briefly to report on, but which we will give you in more detail.

We did an informal survey of 8 percent of our membership. Some 64 museums, about 3 percent of our membership responded—the survey then is obviously statistically imperfect, but does give some insight into the income-producing activity; 27 percent of those 64 filed 990–T forms.

What types of income-producing activities did those museums engage in that was subject to UBIT? Based on that survey there seemed to be three in particular—sale of certain retail products, advertising income and the sale of membership lists to profitmaking operations.

Second, what is the amount of unrelated business taxable income and how much unrelated business income tax is paid? Based on the survey, 10 museums have unrelated business taxable income of which gross average amount was about $22,000, and five paid tax in an average amount of $3,000.

What are the major sources of income for museums which are excluded from UBIT? Endowment represents between 10 and 20 percent of total income, and is received by about 75 of our survey respondents. Rents account for 1 to 2 percent of income, and are received by 63 percent of respondents. Royalties are received by about 26 percent of our respondents.

In summary, we believe the current concept of related business is a good one and that current rules are generally reasonable. To impose a tax on earnings which are related to the museum's mission will greatly impair the financing of museums and could jeopardize those institutions and reduce their public accessibility.

The fragileness of funding for museums has already been shaken by reduced or stagnant public funding by changes in the tax law, and by the ability of the private donors to make up the difference. Further restrictions we feel need to be examined cautiously to assure that our cultural heritage and future generations are not the losers.

I thank you for the opportunity to make this presentation.

[The statement of Mr. Boyd follows:]

STATEMENT
OF THE
AMERICAN ASSOCIATION OF MUSEUMS

I. INTRODUCTION

Mr. Chairman, members of the House Ways and Means Subcommittee on Oversight, we appreciate the opportunity to appear before you today. We appear before you on behalf of the American Association of Museums (AAM), and on behalf of this country's museum community. The AAM is an organization of over 10,000 members, including approximately 8,000 museum professionals and 2,000 art, history and science museums, historic houses, science and technology centers, acquariums, botanical gardens, arboretums, nature centers, zoos, children's museums, park museums and visitor centers.

We are pleased that the Subcommittee has convened these hearings. The museum community welcomes Congressional oversight. We look upon these hearings as an opportunity to tell the Congress about what museums do and how they support themselves. We are also very pleased that the IRS has announced that it will, for the first time, systematically collect data on the income producing activities of nonprofit organizations. Increased knowledge can only lead to a better understanding of nonprofit organizations and to more effective rules and administration.

The United States has over 6,000 nonprofit museums of which approximately forty-nine percent are private, nonprofit organizations, thirty-five percent are governed by state and local governments, nine percent are governed by public colleges and universities, and six percent are governed by the federal government. One-half of all museums are historical museums, most of which are small institutions with collections consisting primarily of objects indigenous to the community or region in which the museum is located. Approximately three-fourths of all museums have annual budgets below $100,000. The total number of museum visits to these various institutions exceeds one-half billion annually, a record of public service unmatched in the nonprofit community.

The diversity of the AAM membership accurately reflects the diversity of the museum community in the United States. The diversity of collections, size and budgets does not, however, detract from the characteristic shared by all museums -- a commitment to an educational mission. In our testimony, we will describe that mission to you and discuss with you how the success of our mission depends upon a variety of fund-raising activities. We also hope to persuade you that the test of relatedness as a condition of nontaxability fairly serves both tax and public policy considerations.

II. PROFILE OF MUSEUM ACTIVITIES

A. Public Service and Benefit

Among section 501(c)(3) organizations, museums are unique. In fact, museums are the most accessible of all types of tax-exempt organizations. As we indicated, it is estimated that over one-half billion visits to museums are made each year. Museum doors are open to anyone and to everyone. No membership test or expensive fee is required in order to enter a museum. The number and the duration of visits to a museum is virtually unlimited. School children and the elderly are often singled out for special treatment and benefits. In short, museums seek to serve the widest possible spectrum of the public.

Whether museums house living animals or dioramas, paintings or machines, virtually all museums maintain and preserve a collection of objects for exhibition. This core function of presenting exhibitions to the public ties all museums together. The challenge to museums is to present their collections in a way that is stimulating to all of its visitors. As a result, museums must develop programs and presentations that appeal to families, students and scholars.

The most important museum responsibility, however, is to its collection, visitors and to future generations. Museum collections are repositories of items that are unique and irreplaceable. The collection of biological specimens that record the earth's history which are preserved at a natural history museum cannot be replenished. Similarly, the vanishing species maintained at a zoo, or priceless artworks on a gallery's walls, can never be replaced. Through their collections and programs, museums offer encounters with reality, with the past, with what exists now and with what is possible. At their best, museums stimulate curiosity, give pleasure, and increase knowledge. Museums acquaint us with the unfamiliar, coaxing us beyond the safety of what we already know.

Museums are gathering places, places of discovery, places to find quiet, to contemplate and to be inspired. They are our collective memory, our chronicle of human creativity, our window on the natural and physical world. The collective significance of museums to American life, their aggregate value, makes museums a national resource. They are the stewards of this country's common wealth -- a wealth of spirit, of substance, and of cultural heritage.

Our nation's museums have a long tradition of scholarship, education and public service. Their contributions to our intellectual and cultural life, their capacity for encouraging inquiry and vision, make them cornerstones of a democratic society. One-half billion people visit museums each year, seeking knowledge, enjoyment and a greater understanding of other peoples, other places, other times. Museums help make their communities pleasing to live in and visit, too; as cultural amenities, they help attract business investment and the tourist dollar.

Outreach programs make up a major part of the public service efforts of museums. Museums host concerts, lectures and seminars in order to provide a more intensive educational experience and to attract new visitors to their facilities. More and more museums are reaching beyond their walls to educate, inform and attract the public. These efforts include the operation of lending libraries for books, records, films, slides and videos, each of which is designed to further the institution's educational mission. Many museums also visit nursing homes, community centers, schools, and rural towns and villages with specially designed programs. These kinds of outreach activities are examples of the commitment of museums to involve the greatest possible number of people in their collections, exhibits and programs.

B. Costs of Museum Operations

Unfortunately, the task of carrying out these responsibilities and fulfilling these goals is a very expensive one. Museums that collect living objects such as zoos, acquariums and arboretums must feed and care for their collections. Museums that collect inanimate objects must maintain extremely high standards of care because of the uniqueness and, in many cases, fragility of the objects in their collections. Moreover, the cost of meeting these obligations can only go up in the future.

Museums are both capital intensive and labor intensive. Caring for the objects in their collections -- whether animate or inanimate -- often requires a sophisticated and costly physical plant. Presenting the collections to the public in an educational and engaging manner requires professionals of great skill. The costs associated with meeting these needs are rising throughout society, and museums have not been spared.

The likelihood of endlessly rising costs also occurs against a background of significantly shrinking government support. Museums, like all other recipients of government assistance, have been forced to make do with less federal, state and local aid. In the last six years, the aggregate appropriations for the principal sources of federal support for museums -- the National Endowment for the Arts, the National Endowment for the Humanities and the Institute for Museum Services --have dropped well below the general inflation rate. As a result, museums have been forced to rely upon other sources of financial support in order to meet their growing commitments to the public and their obligations to their collections. Indeed, museums have been encouraged to seek new sources of support by government officials and policy makers.

The impact of diminished support and rising costs has caught museums in a devastating squeeze. Unlike other cultural institutions, museums cannot cancel seasons or productions to save money. They cannot scale down the fixed costs related to maintaining their buildings and collections. Many museums have been forced to postpone conservation efforts and improvements in storage facilities, restrict research and in-service training, and institute hiring freezes. Other museums have had to cut public programs, curtail hours to save on the cost of security and building maintenance, close some exhibit areas to the public, or reduce staff. When these steps are not possible or not sufficient, museums must raise the fees for admission or membership. Each of these alternatives is inherently inconsistent with the educational mission of the museum.

III. EXEMPTION FROM FEDERAL INCOME TAX

Section 501(c)(3) of the Internal Revenue Code provides that entities organized and operated exclusively for charitable or educational purposes are exempt from all taxes imposed by the Code. The regulations under section 501(c)(3) specifically list museums as an example of an educational organization.

Museums are cited explicitly in the regulations because their activities are so clearly devoted to educational purposes. In the words of the regulations, a museum operates to instruct the public, and to enhance its awareness of, interest in, and appreciation of the institution's collection of materials.

We believe more of the enforcement and compliance resources of the Internal Revenue Service should be directed towards the procedure for obtaining and maintaining tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. Stricter scrutiny of organizations seeking Section 501(c)(3) status will alleviate some of the problems that currently exist in determining whether an organization's income producing activities are related to its educational and other tax-exempt purposes. Organizations in which the underlying tax-exempt purpose is questionable also tend to engage in activities in which relatednesss is hard to determine.

The IRS recognizes that certain activities besides merely displaying the museum's collections and materials contribute to the museum's tax-exempt educational purpose. A museum that engages in such activities furthers this purpose, even if such activity is a trade or business. So long as the revenue producing trade or business is an important contribution to the museum's exempt purpose, the income generated by that trade or business will not be subject to tax.

IRS regulations specifically recognize that an organization may qualify under Section 501(c)(3) even though it operates a trade or business as long as the operation furthers, and contributes importantly to, the museum's exempt purpose or purposes. As we will discuss in the next section of our testimony, museum activities are intimately related to fulfilling its educational purpose. In fact, many of these related activities are educational in and of themselves.

IV. INCOME PRODUCING ACTIVITIES

Museums generally attempt to obtain their financial support through income producing activities in three basic categories: constituent support from donors, members and visitors;

activities related to the management of the museum's resources; and auxiliary activities. The relative importance of each of these income producing activities varies widely among museums. To have any single one of them curtailed would have a severe and direct impact upon segments of the entire museum community. In our testimony today, we would like to discuss these activities with you. In particular, we would like to describe how each of these activities is directly related to the fulfillment of the museum's educational mission and purpose, and how important each activity is to support the museum's programs. Equally important, we belive that understanding the relationship between these activities and museums' educational mission illustrates the strong public policy rationale that supports the continued tax-exempt treatment of the income produced by these activities.

A. Constituent Support

1. Gifts

Gifts and bequests are the lifeblood of museums. Museums and other nonprofit organizations rely on gifts to help fund their operations, but museums alone also rely on gifts to establish their collections. Sometimes the gift is an object and sometimes the gift is cash to purchase an object, but in either case, these gifts are at the very core of the museum's ability to meet its educational mission. In fact, gifts of objects make up approximately eighty-five percent, by value, of all collections of inanimate objects in U.S. museums. Because the principle of receiving a tax-exempt gift is so central to the very existence of museums, we want to emphasize the context in which it must be considered. To treat the receipt of a gift as a taxable activity is tantamount to eliminating the special distinction of gift deductibility under code section 501(c)(3). Therefore, if Congress were to seriously consider taxing gifts, it must be done by way of examining the tax-exempt status rules under code section 501(c)(3), and not the unrelated business taxable income rules of code section 511.

2. Membership Activities

Many museums solicit visitors and other supporters to become "members" of the museum. Membership typically involves a modest annual fee, receipt of a publication containing news about the museum or its collections, and in some cases benefits such as access to parking, dining facilities, and special exhibits. The membership fee really functions as a donation since it exceeds the value of the benefits that are conferred.

Perhaps the most important aspect of membership is that it creates a "stake" in the museum among the members. Membership programs are established primarily to maintain and enhance the interest and support of museum visitors in the museum. The modest benefits are extensions of the museum's educational experience. A good membership program attracts return visitors, encourages new visitors and establishes the museum in the visitor's mind as an educational and enjoyable place to visit, and as an important contributor to the community's well-being.

The publication that goes to members is always related to some aspect of the museum's collection. The benefits of parking and dining are intended to make visits to the museum easier, thereby increasing both the number of visitors and the number of visits. In most cases, the modest benefits are more like an ancillary reward for making a commitment to the museum than a benefit.

The membership program is at the heart of a museum's activities. It is the principal means for building widespread community support, distributing scholarly and educational materials and exploring new sources of financial support. To tamper with membership programs is to risk the long-term stability of museums, generally.

3. Admission Fees

Due solely to increased costs of operation, admission fees are becoming more common in our country's museums. They are, however, never imposed with any enthusiasm. The purpose of museums is to reach the greatest number of people with the educational, aesthetic and cultural richness of its exhibitions, and admission fees represent an obstacle to accomplishing that mission. For that reason, museums admission fees are kept low and alternatives are frequently made available. Many museums still do not charge admission, and of those that do, special rates for children, students and senior citizens are usually available. Many other museums offer free admission on certain days or at certain hours. Still other museums request a donation in lieu of an admission fee. Each of these alternative admissions procedures demonstrate the commitment of museums to their educational mission and purpose. In spite of rising costs, museums continue to explore other avenues to increase access and awareness by and among the people in their communities.

4. Public Policy Considerations

We believe strongly that the public policy arguments against treating gifts, membership and admission fee income as taxable far outweigh any inconsistent tax policy considerations. If such vital sources of income and support were taxable, the museum would be required to raise the fees to produce the same amount of income. Such an increase would have the paradoxical result of discouraging public participation and attendance. That is, museums would find it more difficult to achieve their educational mission and accomplish their public purposes. Thus, the accessibility and availability that sets museums apart from other types of tax-exempt organizations would be compromised. Museums would be forced to become more restrictive and more fee oriented.

B. Management of Resources

1. Endowment Income

Museum endowments are invariably established by the tax-exempt gifts of generous donors. Those museums fortunate enough to have an endowment are required under federal and state law to exercise an extraordinarily high degree of care with respect to the management of endowment assets.

This degree of care is imposed by law because Congress and the various state legislatures correctly understood that institutions established to fulfill educational and other public purposes could not satisfy those obligations unless their assets were prudently managed. Thus, the law explicitly recognizes the "public" nature of museums and other section 501(c)(3) organizations, and the importance of their endowments.

To impose a tax upon the income produced by endowments would be to impinge directly upon the tax-exempt status of the institution. Endowment income is inherently related income. It is created by a gift to the museum, it is regulated strictly to assure availability for public purposes, and it is used exclusively for such purposes. Endowment income cannot be characterized as anything but related.

2. Royalty Income

Some museums have licensed items or images from their collections, names, or other indicia of their identity to commercial enterprises. The Internal Revenue Code provides a special exemption from income tax for royalty income. Thus, the twin tests of relatedness and carrying on a trade or business are not applicable to royalty income.

We believe this exemption is appropriate. Royalties represent recognition of the museum's educational role. Moreover, the item which gives rise to the royalty is a form of educational outreach, attracting the viewer to the institution. The artwork, film or record for which royalties are paid brings the message of the museum to a new audience that might otherwise be unaware of the museum's collection.

In addition, the license arrangements permit museums to protect the integrity of their name or of the object being licensed. Thus, the uses to which the licensee puts his rights can be controlled by the licensor museum so as to advance the noncommercial goals of the institution.

3. Grants

In recent years, many museums have competed actively for corporate grants and for government grants -- many of which require private dollar matches. Although a small amount of government grant funding is available for operations, the majority of grants fund a spectrum of educational activity. Typically, the grant is tied to an exhibition or new program development. The grant covers the research and scholarship that forms the basis for putting the exhibition or program together, it subsidizes the gathering together of objects for the exhibition, and it frequently funds the publication of scholarly works in various media that describe the exhibition. Both the exhibition and the publication attract new people and increase knowledge in the museum generally as well as in the contents of the exhibition. In fact, these kind of grants result in the most visible educational outreach activities of museums.

The significance of the grant for research or scholarship cannot be emphasized too strongly. This is a purely educational activity intended to increase the general level of knowledge in the museum's collection or in closely related fields. While this may be the least visible of a museum's educational activities, it is among the most important. The results of the research benefit all of us by increasing our historic, aesthetic, scientific or cultural understanding.

C. Auxiliary Activities

Museums are engaged in a number of activities to expand and increase their base of financial support. The principal activities, however, may be divided into the following categories: providing services to visitors, educational outreach and advertising. According to an informal poll of AAM members, we believe the share of total museum support from these activities to be approximately thirty-five percent. Moreover, we think a close nexus exists between these activities and the tax-exempt purposes of museums. In general, each of them encourages visitors by making the visits more convenient and the institution more accessible. Convenience and accessibility are crucial to achievement of the museum's educational purpose since they help accomplish the critical first step of getting people into the museum.

1. Service to Visitors

a. Food Service

The principal purpose of the food service is to attract museum visitors and keep them on the premises. In virtually all cases, the food service facilities can only be entered from the museum's exhibition space. Given the fact that a very large percentage of museum visitors are children, elderly or come in groups, restaurant facilities are essential. If there was no food service on the museum premises, most of these people would not attend or, if they did attend, would have to cut their visits significantly shorter in order to eat.

Museum food service offers little, if any, competition to commercial, for-profit restaurants. Our location and inaccessibility from the street insures that virtually all our patrons are museum visitors. In fact, we believe museum food service facilities actually increase opportunities for the food service suppliers and restaurateurs with whom they contract. The supplies purchased by museum restaurants would not all be purchased by another restaurant if the museum ceased dining operations. The total market for supplies is increased by the museum, thereby providing additional revenues.

b. Parking Lots

Parking lots that are operated during museum hours and do not seek non-museum visitor patrons produce income that is related to the museum's educational purposes. Like museum food service facilities, parking lots increase the accessibility of the museum. Without parking facilities, the number of people able to benefit from viewing the museum's collection surely would decline.

2. Educational Outreach

a. Special Facility Uses

Museums occasionally lease portions of their premises to third parties. The rental of museum space inevitably attracts visitors to the museum, and provides an opportunity to see the collection to people who would not otherwise be there. Groups that rent space are not only exposed to the museum but the rental frequently includes a special tour of the museum facilities or other activities to make the visitors aware of the museum's collection and programs.

b. Retail and Catalog Sales

Virtually all museums maintain museum shops and many large museums also operate a merchandise catalog sales program. In general, retail sales from these sources constitute the largest source of income from auxiliary activities. The single most important function of the museum shop is to perpetuate the experience of the visit. The objects for sale are carefully selected to include reproductions or other items related to the collection that will enable the visitor to reflect upon the visit. The educational nature of the items is enhanced by descriptive material. Catalog sales are somewhat different since the catalog purchasers are not necessarily recent visitors to the museum. Nevertheless, the catalog items are intended to educate the purchaser and to encourage a visit to the museum. The format of the catalog is devoted to providing educational as well as sales information.

The decision of the museum shop and catalog director is based upon a set of considerations that go far beyond questions of profitability. First and foremost, the museum's curatorial staff is consulted on the selection of the items, the content of the descriptive material that accompanies their sale, and the nature of their presentation for sale. All of these steps are undertaken to assure that the educational mission of the museum is enhanced by its museum shop inventory and catalog. In addition, once selected, items are held in inventory for a much longer time than would be true of a commercial retail store.

The current rules with respect to what constitutes related income from retail sales have been developed through ruling requests, general counsel memoranda and other directives. We believe these rules are now generally understood and accepted. The test for relatedness is fact-based and applied separately to each item. Museums must select items that specifically relate to the museum's collection or exhibitions and are educational. Thus, reproductions and adaptations of items in a collection or exhibition produce related income. Interpretive items or period items accompanied by descriptive materials also produce related income.

Utilitarian and decorative items will be treated as producing related business income so long as the utilitarian aspect of the item does not dominate its educational nature. We believe that items are related if they serve to interpret a facet of the museum's collection. We are concerned that the educational aspect of an item has not always been sufficient to insulate its sale from tax. In fact, the educational nature of an item is not compromised -- and may be enhanced -- by its utilitarianism.

We believe it is very important to emphasize the scope of items museum shops can sell on a tax-free basis. The requirement that the museum shop or catalog inventory be related to the museum's tax-exempt purpose imposes limitations to which no other retailer is subject. In addition, it means that museums cannot and do not select items on the basis of what will sell the most or produce the greatest return. The first consideration is always whether and to what extent it relates to the collection.

With respect to any item that is not in or adapted from the museum's collection or an exhibition, is not accompanied by descriptive information of a substantial nature, or otherwise derived from collections and exhibitions, tax will be imposed. This narrow museum shop inventory cannot compete with a commercial enterprise. No commercial enterprise would be willing to carry only items found in a particular museum. No commercial enterprise would be willing to maintain in its inventory for a prolonged period of time, items that reflected the historical period of a particular museum's collection even if the items did not sell. Museum shops, however, must operate under these limitations. Moreover, the items carried in the shop or catalog are often the work of highly-skilled craftsmen and other small business entrepreneurs who, if not for the museum shop, would have no outlet for their services. Thus, the general commercial climate is enhanced rather than diminished by museum shops and catalogs.

c. Tours

Museum tours are generally highly structured events organized around very clear educational purposes and objectives. The tours include lectures, seminars and guided instruction. The attraction of the tour is the significant educational component included in the travel. Moreover, almost all museums that provide tours use the services of commercial travel agencies to organize the trip. Consequently, the aggregate business of the agencies is increased by the museum's activities.

3. Advertising Income

The treatment of advertising income from section 501(c)(3) periodicals is very strict. Unless the commercial activity of accepting advertising "contributes importantly" to the museum's exempt educational function the advertising revenues will constitute income from an unrelated trade or business.

The Supreme Court has agreed with the IRS that the statutory language "substantially related" required the advertisements to "contribute importantly" to the museum's educational purposes. Despite the informative nature of the advertisements in the journal, the Court declared that the advertisements failed to serve an identifiable educational objective. Thus, only the income from those advertisements that relate specifically to that issue's content will be nontaxable. Income from advertisements that are generally educational only or that obviously reflect the advertiser's marketing strategy will be taxable.

We believe the principles underlying these rules are reasonable. However, since most museum publications go to members only and no serious effort is made to recoup publication costs through membership or subscription fees, the Supreme Court's narrow interpretation of these principles may be too restrictive.

4. Tax Accounting

The tax-exempt treatment of income earned by such section 501(c)(3) public service organizations as museums is a function of the income tax accounting rules as well as public policy considerations. The normal rules of income measurement do not apply to museums.

Our income tax system is based upon the ability to pay. Since everything that is contributed to a museum is, or shall be, distributed to the public in the form of services, the only appropriate tax rate to be applied is the average rate of the ultimate recipient -- the public. To use any other rate would be inconsistent with the fundamental premise of the income tax system. In fact, to use any other rate would be highly regressive since the effect of collecting the tax would be to deprive low- and middle-income people of the benefits of museums to a disproportionate degree.

Tax-exempt museums are operated exclusively for educational and charitable purposes. The income tax is applied to enterprises operated exclusively for profit. Rarely, if ever, can these objectives be satisfied by similar means if the first objective is being scrupulously pursued.

If the related income generated by a museum bookstore or restaurant is to be used exclusively to restore a painting, feed a panda, or mount an exhibit, then the expenditure of the income would have to be treated as an ordinary and necessary business expense. If the income is accumulated for a year to be spent for the preceding purposes (or other educational purposes) in the following year, then it should be accrued as an expense.

The point is that a museum that fulfills its obligation for section 501(c)(3) status is not constituted to maximize profit. The costs associated with each item of income are permeated by the educational mission of the museum in ways that do not apply to commercial endeavors properly subject to the income tax.

Under these circumstances, the income tax rules cannot be logically applied. Thus, the key question should always be whether the museum is organized and operated for tax-exempt purposes. If it is, then related income cannot be taxed under principles that assume the taxpayer is motivated to maximize profit. Only the unrelated income which is not connected to the tax-exempt purposes of the museum can be subject to the ordinary rules of tax accounting.

V. CONCLUSION

As we have tried to suggest throughout our testimony, the primary focus of inquiry ought to be whether tax-exempt organizations are organized and operated exclusively for tax-exempt purposes and, if so, what is the relationship between satisfaction of those purposes and the income producing activities of the organization.

Museums believe that the current concept of related business is a good one and that the current rules are generally reasonable. Imposing a tax upon the activities related to an organization's tax-exempt purpose can only produce fewer public benefits and force museums to devote more attention to unrelated and more profitable activities. Such a result is clearly not in the public interest.

Finally, we urge the Congress to assemble sufficient data before it acts. Museums and other section 501(c)(3) organizations have been buffeted by significant changes in recent years.

Substantial uncertainty in the museum community has been created by changes in the tax rate structure and the new appraisal standards. The inclusion of gifts of appreciated property in the minimum tax and the elimination of the deduction for non-itemizers are almost certain to reduce to some extent the support which museums have received. While the full impact of any one of these, let alone all of them, is not yet known, the potential for damage is clear. To change the rules once again will only add to the uncertainty and increase the likelihood of damaging the financial health of organizations providing undeniable public benefits.

Thank you again for the opportunity to testify. Museums are prepared to help the Congress, the IRS and the GAO in any way we can to develop the necessary data, and we look forward to doing so.

Mr. **Flippo** [presiding]. Thank you, Mr. Boyd. I believe you have some distinguished guests with you.

Ms. **Campbell**. Mr. Chairman, I am Mary Campbell, executive director of the Studio Museum of Harlem. The Studio Museum is a black fine arts museum that collects exhibits and interprets African, Caribbean and African-American art. We were founded in 1967 during the heart of the civil rights movement, and in our first decade we maintained a modest budget of about $300,000, 90 percent of which was composed of public funds.

In those early days earned income was virtually nonexistent. Deficits flourished in that environment and programmatic stability was elusive. I am happy to say that now in our 20th year the studio museum operates with a budget of $2 million, that our public support has dropped dramatically to 45 percent of our total operating budget, and earned income, approaching the $500,000 mark, is 23 percent of our total operating budget.

This radical change in the studio museums earned income capability has been accompanied by a radical improvement in the museum's ability to deliver services to its constituency. We believe that programmatic excellence requires fiscal stability; that fiscal stability can be earned, and that a stable, healthy institution is especially vital for a community like ours, central Harlem.

The increase in earned income for us occurred when the studio museum was given a 60,000-square ft. building in 1979 in the heart of the Central Harlem business district. Half the building is occupied by not-for-profit tenants, the other half was converted to premiere museum space and also a museum shop was installed.

The tenant rental provides 11 percent of our total budget; the shop, 5 percent. The remaining income comes from publications, memberships, admissions, program fees and so on. This financial architecture helps us sustain a rather ambitious set of programs in the heart of central Harlem: Exhibits, which often travel nationally and internationally, publications that are the public's major source of information on black American art, an artist-in-resident program that gives emerging minority artists space and support, a set of educational programs that includes placing professional artists in public schools in Harlem, and public programs that bring major figures into our community.

Perhaps equally as important as programs has been the studio museum's stabilizing presence on 125th Street. The fact that we salvaged a previously half vacant, deteriorating building on West 125th Street, renovated it and transformed it into a viable piece of commercial property, the fact that we maintain that property for social service agencies, educational agencies and legal services, is as important as the exhibits we do.

We employ close to 500 full-time staff about one-third of them Harlem residents. We provide seasonal employment and training to dozens of other minorities, especially black youth, in summer jobs and after-school opportunities. We have attracted over 50,000 visitors on an annual basis to Harlem, thus providing stimulus to other businesses in that district.

Like other minority cultural institutions, the studio museum in Harlem is not a rich institution. We have no endowment. We have no sizable cash reserve. We have no wealthy patrons waiting in the wings to help bale us out. The bulk of our constituency is poor to middle class. We are able to do what we do because we are prudent, resourceful and enterprising. To tax our efforts would seriously undercut our ability to achieve a measure, albeit modest, of self-sufficiency and would seriously impair our ability to provide services to a population that is traditionally underserved.

We believe that more than ever our urban communities need models of fiscal independence and strong institutions to shore them up and support them in the face of an increasingly hostile and adversarial environment. Thank you.

Mr. **Flippo**. Thank you.

Mr. **McQuarie**. I am Bob McQuarie, director of the Littleton Historical Museum in Littleton, CO, a community located in the Denver area.

My type of museum, the historical agency, represents about 50 percent of the museums in this country. The Littleton Historical Museum was created through the joint efforts of a nonprofit historical society and the city of Littleton and opened its doors to the public in 1970. From very meager beginnings, the institution has grown from one building to 20-some different structures and today includes the museum with exhibit galleries and offices, two living history farms and other historical buildings and a collection in excess of 30,000 items that support our educational purpose of collecting, identifying, and furthering the understanding of the history of the Littleton area and those ideas that continue to affect citizens today.

The collection of objects, photographs and artifacts acquired in 17 years mostly by gifts and earned income is valued at over $4 million plus several historic buildings and structures acquired by gifts and earned income valued at half a million dollars.

The maintenance of our facilities, the staffing and operation of the museum and its programs are funded from municipal tax dollars at a level of nearly $500,000 as a city department. However, the accomplishments of our educational institution in the last 17 years could not have been made without additional income derived from ongoing private support of gifts and grants and funds raised through earned income generated by book sales and craft products sold at the museum, paid membership, rental of facilities and other routine projects that grossed us about $70,000 last year.

The museum and our nonprofit support group, the Friends of the Museum, use the earned income to support the museum's programs of education. Earned income raised by the Friends of the Museum has been used to buy 19th and 20th century collection items, to furnish our historic farms and buildings, to purchase livestock and original 19th century equipment so necessary to accurately interpret Littleton family life in the 1860's and 1890's plus providing costuming for staff and volunteers, conducting public lecture series and training staff and volunteers to improve the demonstration activities in our living history program.

In addition to our lectures, concerts, publications and outreach programs for schools, senior citizens, the handicapped and general citizenry, the museum has conducted a summer education program since 1972, one that is extremely important to us. Each summer during 10 1-week sessions, 230 children spend a week at the museum and over 30 hours of intensive work during which time they assume the role of adults in the latter part of the 19th century and learn from actual work how the community was built.

They touch, use and experience what a historical museum could provide in a 20th century urban city. However, without the additional money we have generated from earned income to add to the municipal budget, this program would not be. It is a program some have said is unique in history museums in the Nation. As for the further development of the museum, it must be supported by more than earned income. We do not charge admission and sincerely hope to forestall this through expanded book and craft sales so that our educational offerings will be equally available to all residents. Thank you.

Ms. **Barsook**. I am Beverly Barsook, executive director of the Museum Store Association. Museum stores are a program of the museum and in the interest of time and at your request, we have had our remarks integrated with those of American Association of Museums.

Mr. **Flippo**. We will include all the remarks in the record.

Mrs. Blanton?

STATEMENT OF LAURA LEE BLANTON, MEMBER, BOARD OF DIRECTORS, AMERICAN COUNCIL FOR THE ARTS

Ms. **Blanton**. Mr. Chairman and members of the subcommittee, with your permission, I would like to summarize my written statement. I am Laura Lee Blanton, and I am a member of the board of directors of the American Council for the Arts. On behalf of ACA, I am pleased to have the opportunity to appear before your subcommittee to testify on the issue of the unrelated business income tax.

The American Council for the Arts is one of the Nation's primary sources of information on issues affecting all the arts, and strongly opposes any initiatives which would limit or eliminate any programs or services that are currently provided by nonprofit organizations that serve to help develop the arts community and bring the arts to the general public.

ACA communicates as a publisher of books, journals, newsletters and commission papers to foundations, corporations, educators, artists and managers of arts organizations so that the arts might flourish and grow in this country.

Arts leaders rely upon ACA books immensely. One book ACA distributes, "Waiting in the Wings: A Larger Audience for the Arts and How to Develop It," argues that the only way to reach new audiences is through a new vision which they call SELL, the strategy to encourage lifelong learning.

ACA believes that a book like "Waiting in the Wings" is important in making the arts become more self-sufficient. The question is whether this service to the arts community is a threat to small businesses.

The answer is no, evidenced by a look at the profit-loss margin. I do want to make the point that the American Council for the Arts does not pay any unrelated business income tax.

A majority of ACA's revenue is obtained through the sale of books. It is projected that in fiscal year 1987, ACA's revenue from book sales will account for $133,000, direct expenses for the publication and distribution of these books in the same fiscal year are projected to be $196,000.

This means that the ACA is operating this service to the arts community at a loss of $63,000.

Additional revenue is obtained through membership dues, annual benefits and so forth. The publication of these books is not a profitmaking venture. Without ACA, arts leaders would not have the opportunity to obtain this information.

Typically a for-profit publisher prices the books they sell four to eight times the cost of manufacturing that book. ACA, however, is faced with a much smaller audience and no mass market for its books.

We are involved in this activity because it is related to the exempt purpose of the organization which is to educate artists and arts leaders about the latest information facing the arts and provide the public with greater awareness of the arts, all with the aim of advancing the arts in this country.

Revenue that a museum or nonprofit theater obtains through the sales of prints or a shirt is placed back into the organization with the objective being to rely less upon Government funded support, not to undercut private business activity.

Funding for the arts has not been exempt from efforts to reduce the Federal deficit. From fiscal year 1981 to 1987 Federal Government support for the National Endowment for the Arts has grown only 3.9 percent. As a comparison, another 7-year period from fiscal year 1975 to 1981, Federal Government support for the National Endowment for the Arts grew by almost 53 percent.

Another example demonstrates how inflation has also entered this picture. While the NEA in fiscal year 1984 received appropriation of $162 million in constant 1967 dollars, the agency received only $52 million.

Mr. Chairman, let me conclude by saying that a for-profit organization will over the long run only provide services that make a profit. I want to thank you for the opportunity to testify today, and would welcome any questions you might have.

[The statement of Ms. Blanton follows:]

TESTIMONY OF
AMERICAN COUNCIL FOR THE ARTS

Mr. Chairman and members of the Subcommittee, my name is Laura Lee Blanton and I am a member of the Board of Directors of the American Council for the Arts (ACA). On behalf of the ACA, I am pleased to have the opportunity to appear before your Subcommittee to testify on the issue of the unrelated business income tax.

The American Council for the Arts is one of the nation's primary sources of information on issues affecting all the arts, and serves as a leading advisor to arts administrators, educators, arts patrons, and the general public. ACA's arts library, now part of the 15,000 volume collection of the Arts Resource Consortium at Equitable Center, contains extensive material on arts education, policy and management.

ACA promotes thoughtful public debate in various national, state and local forums. It communicates as a publisher of books, journals, newsletters and commissioned papers to foundations, corporations, educators, artists and managers of arts organizations.

ACA is particularly active as a focus of support for arts education in the schools, primarily grades K-12. It addresses the needs of individual artists in areas such as copyright, funding and tax legislation, encourages the development of private-sector initiatives, and promotes international cultural relations.

Mr. Chairman, as you can evidence, the American Council for the Arts involvement in the arts is extensive. However, unlike a theater, museum or dance company, the American Council for the Arts is a service organization for the arts. I must stress the word service, for this is the root of our existence and our primary function to the arts community. ACA is not the producer of the latest hit play. ACA is not involved in the training of our young dancers. ACA is not involved in bringing our country's symphony orchestras to numerous audiences through concerts in parks and community settings. What ACA is involved with is bringing information to our artists, arts administrators and the general public so that the arts might flourish and grow in this country. ACA's mission is to help forge new initiatives which can effectively advance the role of the arts in America.

A major activity of the American Council for the Arts is the publication and distribution of books that explore new and difficult issues facing the arts, teach valuable skills, disseminate factual and resource information, and provide a central data source for those working professionally and avocationally in the arts.

Among the long list of publications are books such as "Supporting Youself as an Artist: A Practical Guide", "The Art of Filing: A Tax Workbook for Visual, Performing, Literary Artists and Other Self-Employed Professionals", "The Road Show: A Handbook for Successful Booking and Touring in the Performing Arts", "The Arts Go to School: An Arts-in-Education Handbook", "Financial Management Strategies for Arts Organizations", "Subscribe Now! Building Arts Audiences Through Dynamic Subscription Promotion", and "Live the Good Life! Creating a Human Community Through the Arts."

Our leaders in the arts rely upon these books immensely. As an example, one new book which ACA distributes is "Waiting in the Wings: A Larger Audience for the Arts and How to Develop It" written by Bradley G. Morrison and Julie Gordon Dalgleish. This book examines the evolution of audience development over the past thirty years and argues that the only way to reach new audiences is through a new vision which they call SELL, the Strategy to Encourage Lifelong Learning. What they suggest is that arts organizations take the responsibility of introducing and educating the public in order to develop audience and supporter bases. For the theaters, orchestras, and opera companies across this country, selling tickets and filling the house is the name of the game. By placing more people in those seats, these companies rely less and less on public support. It is our belief that a publication like "Waiting in the Wings" is important in seeing that the arts become more self-sufficient.

The question we address today, however, is whether or not this service to the arts community is a threat to the small business community. Mr. Chairman, I must say emphatically that it is not.

Mr. Chairman, I think the answer as to whether or not the publication of these books by ACA poses any threat to the small business community can be evidenced quite simply by a look at the profit/loss margin.

It is projected that for Fiscal Year 1987, ACA's revenue from book sales will account for $133,200. Direct expenses for the publication and distribution of these books in the same fiscal year are projected to be $196,464. This means that the American Council for the Arts is operating this service to the arts community at a loss of $63,264. If this were a profit making venture, Mr. Chairman, as a businesswoman I would have to tell my colleagues to get out of the publication of these types of books as quickly as possible. I, as well as other businessmen and businesswomen in this country, are operating their companies to make a profit. If the expenses of providing the service to a consumer exceeds revenues then the company must close. Besides the lack of profit, the quantity of books sold would not be attractive to a small business.

The arts community, however, is fortunate not to have to be faced with this drastic solution. It is to the great benefit of those working artists and arts administrators that the American Council for the Arts does exist as a non-profit organization and has the capacity to obtain grants which offset these losses. For without ACA these arts leaders would not nave the opportunity to obtain the information which exists in these publications. The revenue producing activity of ACA is not unrelated to the operations of the organization or the arts but entirely related. It is related to the performance of the arts field as a whole.

One simple solution to eliminating losses that might be proposed by a for-profit business would be to raise the price of books until a profit is returned. As I said this is the simple answer but not the right one. Typically a for-profit publisher prices the books they sell four to eight times the cost of manufacturing that book. This is possible because their market is much greater than ours. ACA is faced with a much smaller audience and no mass market for its books. Purchasers of ACA's books are individual artists who as you know a majority of which earn very little income from their profession or arts administrators whose operating budgets are already strapped beyond means. If ACA were to raise the price of its books by such a margin as for-profit publishers, the price of these specialized books would eliminate many possible consumers and therefore result in reduced revenue to meet the operating costs. Providing this service to the arts community is not a profit venture.

The American Council for the Arts in not in the business of providing books and publications to the arts community to offset losses in other areas of operation. ACA is involved in this activity simply because it is related to the exempt purpose of the organization which is to educate artists and arts leaders about the latest information facing the arts and provide the public with greater awareness of the arts, all with the aim of advancing the arts in this country. ACA provides this service because the arts community needs and demands these books and the for-profit business sector can not and will not provide them.

As I outlined in the beginning of my testimony, while the publication and distribution of books accounts for just over fifteen percent of ACA's total revenue and support, ACA is involved in much more. ACA plays an instrumental role in the nation's arts community as a leader in the public debate on issues affecting the arts. Among some of the activities are seminars for artists so that they might better understand the procedures in applying for grants from private foundations or holding regional meetings to discover successes in arts education programs that might be shared with other communities across the country. Once again, I must stress that at the root and behind all intents is the idea of providing a service to the arts community from which it can grow and expand.

Mr. Chairman, during your hearings and your investigations into the issue of the unrelated business income tax, you will hear from a variety of witnesses representing various aspects of the arts community from museums to theaters to orchestras. You will hear about gift shops that bring revenue into museums and theaters. A key word in that sentence is revenue; what is absent is the word profit. In whatever case imaginable the objective is to provide the service to the arts. The revenue that is obtained through the sale of a print or shirt is placed back into the museum or theatre with the objective being to relieve the reliance upon government funded support and not attempt to gain an unfair advantage over private businesses or undercut private business activity. For an arts institution that has the great fortune of having excess revenue over expenses, the surplus is placed back into the organization to cover losses in the future or to create new programs that will serve the artists and/or the general public. No private individual will benefit from the surplus, unlike a for-profit organization where the excess revenue over expenses goes to the owners.

Mr. Chairman and members of the Subcommittee, as you know only too well in these times of reducing the federal deficit, government support for many programs has had to be drastically reduced. Funding for the arts has not been exempt. From Fiscal Year 1981 to the current Fiscal Year 1987 federal government support for the National Endowment for the Arts has grown a total of just over 3.9 percent. This is less than 4 percent in seven years, Mr. Chairman. As a comparison, during another seven year period from Fiscal Year 1975 to Fiscal Year 1981, federal government support for the National Endowment for the Arts grew by almost 53 percent. Another example demonstrates how inflation has also entered this picture. In Fiscal Year 1981 the NEA received an appropriation of $158.795 million. However, using 1967 as the base year, in constant dollars the NEA only received in Fiscal Year 1981 $58.278 million. Even more alarmingly is Fiscal Year 1984 when the NEA's appropriation rose to $162.223 million but in constant dollars the agency suffered a decline to $52.236 million or over an eleven percent reduction from Fiscal Year 1981.

The lack of additional government support and the erosion of inflation has prevented many arts organizations from expanding programs to new arts audiences of this country. Other arts organizations have had to eliminate programs that reached out into rural and urban communities. Included in the declaration of purpose of the "National Foundation on the Arts and Humanities Act of 1965", which created the National Endowment for the Arts, it states that Congress hereby finds and declares "that a high civilization must not limit its efforts to science and technology alone but must give full value and support to the other great branches of mam's scholarly and cultural activity in order to achieve a better understanding of the past, a better analysis of the present, and a better view of the future." The point I want to make is that while the arts community has had to rely less and less on federal support for the arts, the arts have continued with the mission to someday fulfill this declaration. A declaration that is meant for all citizens of the United States. To increase the level of tax on unrelated business income would result in the depletion of revenues for arts organizations and cause them to once again place heavy reliance on public support.

Simply because there is less government support for the arts to develop some innovative program to reach new audiences or present some new artist to the world does it mean that the arts fold up and disappear? I am proud to say that the arts in this country have survived and will continue to survive. A for-profit organization will, over the long run, only provide services that make a profit. The arts community can continue to provide services even when it is not economically advantageous to do so, either because they receive charitable contributions or because they are prepared to operate on a long term break-even basis. Faced with reduced federal support the arts community has had to seek other means of obtaining revenue. Some of these ventures have been criticized as placing unfair competition on services being provided by small businesses.

While today's museums sell prints of paintings, I find it hard to believe that a community's arts dealers or galleries are any less profitable. The clientele for these two sectors, because of the price structure of the products beings sold, are entirely separate. The price of many paintings sold by dealers or galleries are beyond the means of the average citizen. However, for much less, a print of a painting may be sold to someone who, over time, will further develop his interest in art and may ultimately buy from that dealer or gallery. The two sectors work together, each expanding and developing the arts. Rather than competition there exists a somewhat mutual dependence.

Mr. Chairman, the American Council for the Arts would strongly oppose any initiatives which would limit or eliminate any programs or services that are currently provided by nonprofit organizations that serve to help develop the arts community and bring the arts to the general public.

I want to thank you for the opportunity to testify today and would welcome any questions that you might have.

Chairman PICKLE. I thank you, Ms. Blanton and thank you, Mr. Boyd and the group who accompanied you.

The Chair will take the privilege of saying to Mrs. Blanton that we appreciate your testimony. I did not realize that in the publication of your book, that you have actually lost some $63,000 and that would not be subject to taxation, I assume?

Ms. BLANTON. Right.

Chairman PICKLE. I know the great work being carried on. Has the income-producing aspect of your arts group there in Houston, have they changed much over the years?

Have you added a lot of ways of making money? Is it basically the same?

Ms. BLANTON. We are basically the same.

Chairman PICKLE. Besides the book, what are some of the other things you do that would be income producing?

Ms. BLANTON. That is about it.

Chairman PICKLE. That is about it, primarily the book. Do the UBIT rules which are in existence now——

Ms. BLANTON. We do not pay UBIT tax.

Chairman PICKLE. Do the UBIT rules inhibit your activities to pursue your tax exempt purpose? Even if you owed UBIT, you could pay it but you do not pay it now?

Ms. BLANTON. We are on a very tight budget, in fact, in the red most of the time, trying to raise money by donations from people and foundations. So every dollar that we have counts, and if we had to pay taxes, it would be larger burden on our group.

Chairman PICKLE. You have indicated that donations may be about the only source of revenue that you have over and above your regular art work.

Ms. BLANTON. Yes.

Chairman PICKLE. You also noted that Federal support has been reduced. For my information, what amount of Federal support for the arts do we have now, do you know what that percent is?

Ms. BLANTON. In the Federal budget?

Chairman PICKLE. Yes. Have we eliminated that completely? Anybody know?

Mr. Boyd, do you know whether——

Mr. BOYD. No. The National Endowment for the Arts' budget is $170 million, I think, at this juncture, and it has grown slowly in recent years, but was not reduced 50 percent as originally recommended, but it has not really grown and, therefore, we are facing basically stagnant public funding.

Chairman PICKLE. That budget will be approximately the same as last year, but with no growth in it?

Mr. BOYD. That is right.

Ms. BLANTON. Very, very small.

Chairman PICKLE. I found your testimony very interesting, Mrs. Blanton, and again, I certainly appreciate your presence here. We appreciate your testimony.

Mr. Schulze, I know Mrs. Blanton needs to catch a plane. If you wish, you may excuse yourself.

Ms. BLANTON. Thank you very much.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. I just have one question of the panel. And that is, do you see so-called unrelated business income growing when you look at your colleagues and peers in other museums around the country?

Is it a source of income, a necessary source of income? Do you see growth in the future, or are bells going off unnecessarily?

Mr. BOYD. I think there is a big bell going off about the survivability of museums right now because if public funding is stagnant and not growing, and when we were told to depend more on the private donor and the private sector said we cannot furnish you enough to make up that difference——

Mr. SCHULZE. From all the figures that we have seen, private contributions are increasing.

Mr. BOYD. Not for us.

Mr. SCHULZE. If they are increasing overall, and you are not getting your share, maybe there is a message there.

Mr. BOYD. We are working hard in every area to keep these places afloat.

Mr. SCHULZE. You are finding it difficult to get the support of the public, is that what you are telling me?

Mr. BOYD. I am saying that basically as you look at the private dollar cultural institutions such as ours are at the bottom of the donor totem pole, yet we rely on them more. So, yes, we are having a struggle.

I think basically our related income activity remains of the same nature as over the years. We cannot afford to lose that. Many of these have been convenience services and we are trying to make a profit from them because we can't subsidize them any longer and we are in need of the income.

Mr. SCHULZE. You see it growing but because it is a necessity?

Mr. BOYD. That is right. We don't want to get beyond anything that is related because basically we are program oriented and that must remain our central focus.

Mr. SCHULZE. Would it concern you if a couple of the large museums in the country suddenly dominated the souvenir or reproduction business, somebody put out a catalogue the size of the Sears catalog and it was taking all that business, would that cause you concern?

Mr. BOYD. Since I am not in the souvenir business, it wouldn't cause me much concern.

Mr. SCHULZE. That is one of the trends that causes concern, whether we see that type of activity.

Mr. BOYD. Obviously, I think that reproductions are important because they create greater understanding of what your collection. One of the problems we have is to get greater public understanding of the nature of the collections.

Mr. SCHULZE. Anyone else?

Ms. CAMPBELL. I would like tc comment on the availability of public funds for museums. Although funding for the National Endowment for the Arts is growing slowly, I think other sources of public funds such as UDAGs or community development block grants, are no longer available to the museums as they have been in the past, so that is a substantial reduction in public funds.

I think that when museums use related programs for income, I think it is a very healthy measure of their ability to gain some measure of self-sufficiency and I think it shows public participation in that museum, public willingness to support that museum.

Mr. SCHULZE. Would you agree that public support is important and that it also is a symbol of the ability of the organization to relate to the community?

Ms. CAMPBELL. I am sorry. By public support, what are you referring to?

Mr. SCHULZE. Contributions, funds, entrance fees, financial support from the community or from the public to an institution.

Ms. CAMPBELL. Yes, I think that public support shows support for an institution and that can come in the form of outright contributions, but it can also come in the form of support for the institution's earned income programs, as well.

Ms. BLANTON. I work in several fields of the arts, museums, a lot of things. I am a professional volunteer. With the Government cutting down on the income tax that they can take off, it has cut down on our revenue from the private person. With so many of the companies in the United States merging——

Mr. SCHULZE. Let me parenthetically stop you there for a second.

Ms. BLANTON. With the income tax law change——

Mr. SCHULZE. I understand what you are saying. I have had many people tell me that and have yet to have anybody come in and give me cold hard facts on that. If you have some, please send them to the committee, because the entire Ways and Means Committee is anxious to have that information.

What we did with the tax bill, we did not try to destroy charitable contributions in the country. We had all kinds of studies showing it would be on the upswing. We know there was a surge last year.

Ms. BLANTON. Our other problem is so many of our large contributors of large corporations are merging and they don't then give twice as much as they used to. They merge into one price. This has hurt several of the groups that I belong to and I can send you facts on that, of the big mergers.

Mr. SCHULZE. Do statistics on corporate contributions show that they are increasing dramatically?

Ms. BLANTON. They are, but when one corporation that gives $10,000 merges with another corporation that gives $25,000, they don't seem to give $35,000.

Chairman PICKLE. What do they do normally, just take an amount in between——

Ms. BLANTON. They try to get along on $25,000. But we always try to get them to give, like, $30,000.

Mr. SCHULZE. Does anybody want to respond to the passive income question? Does anybody have large amounts of passive income?

Mr. BOYD. If you are speaking about endowment, it is crucial to us, although a decreasing factor because of erosin due to inflation. If we can get bequests, we admit to it, but obviously that is a key thing to us.

Mr. SCHULZE. The reason I asked the question, you know there is a proposal to tax passive income of tax-exempt groups. I am asking to give you the opportunity to make a statement.

Thank you, Mr. Chairman. I have no more questions.

Chairman PICKLE. Let me ask you, Mr. Boyd, have you had complaints against the operation of your museum, about your operation as far as competing with private enterprise?

Mr. BOYD. I have had one complaint from a wonderful supporter of the museum who registered his first complaint about 30 years ago and it has to do with the fact that he is an operator of a book store in Chicago and, while he is not opposed to ours, he frequently reminds me that he thinks that we should not be in the book store business. That is my only complaint.

I have to say that our museum was named after a man, a principal donor. It is the only building in Chicago given by one person, Marshall Field, who started a department store there and immediately thought we ought to have an opportunity to sell materials related to the museum so that the public would be able to have a lasting commitment in the sense of what it is we do at the museum.

So we have a lot of merchants on the board and they have not complained about this.

Chairman PICKLE. The regulations concerning UBIT, are they a bother to you administratively, and difficult for you to follow?

Mr. BOYD. No, because basically we want to stay in the related business. Our business is museum, conservation, collecting and exhibition. We can't go into a lot of unrelated stuff.

We were audited two years and they said that what we were doing was related. As I mentioned earlier about our survey on those who are filing 990T, it would appear that most of the museums are focused on the relatedness.

Chairman PICKLE. You mentioned your survey. The committee would like to have more information on that. I would like to know from your survey what categories are related, what you consider unrelated and what you are paying tax on, and have a breakdown for each category.

Will you furnish that for the committee?

Mr. BOYD. Yes. I was able to give a short oral summary but we will give you the written one.

Chairman PICKLE. I want to ask the panel again, the Treasury made recommendations about suggestions we might make to strengthen the UBIT program.

Are you familiar with them—your group or Mrs. Blanton?

Mr. BOYD. We just saw them this morning so we haven't really had a chance to digest them. We would be glad to give you a written submission after we have had a chance to look at them.

[The following was subsequently received:]

American
Association
of
Museums

August 13, 1987

The Honorable J.J. Pickle, Chairman
Committee on Ways and Means
Subcommittee on Oversight
1105 Longworth House Office Bldg.
Washington, D. C. 20515

Re: Ways and Means Subcommittee on Oversight Hearings on Unrelated Business Income Tax

Dear Chairman Pickle:

During the hearings on UBIT, the members of the Oversight Subcommittee asked the witnesses who spoke on behalf of the American Association of Museums (AAM) and the museum community the following:

1. To share the findings of the AAM survey regarding sources of financial support for museums;

2. To respond to the proposals of the Treasury Department on unrelated business income tax;

3. To comment upon the imposition of an excise tax on endowment income; and

4. To comment on the current situation of charitable contributions to cultural organizations.

In this correspondence, we will respond to each of these issues.

AAM SURVEY

The survey was mailed to approximately 160 museums (8% of our institutional membership), and 64 responded. No attempt was made to develop a statistically reliable data base and, as a

1225 Eye Street
Northwest
Washington DC
20005

Telephone
(202) 289-1818

result, the conclusions to be drawn from the survey should be considered, at best, to represent only general and broad conclusions. In addition, follow-up with certain museums has demonstrated that some responses are incorrect because the respondent did not fully understand the question.

In order to provide you with the survey information in the most reliable manner, we have (with one exception due to the uneven number of responses) divided the responses into groups of ten based on the size of the museum's operating budget. Thus, the first group of museums consists of the ten largest museums as determined by annual budget and the last group consists of the four smallest. Attachment I contains a chart of the various responses.

We believe the data generally show the significance of earned income (called "auxiliary service income" in the AAM statement to the Subcommittee) to museums as well as the clear relatedness of the activities producing such income to the museum's exempt purpose. These two facts emphasize the extent to which museums are devoted to the performance of their exempt purpose. This data cannot be interpreted to suggest that museums never engage in such entrepreneurial activities as partnerships and joint ventures, but it does illustrate the infrequency of such efforts.

Most important, the data illustrate what we believe should be a fundamental principle in the Subcommittee's consideration of UBIT: the "relatedness" test works. Museums (and other tax-exempt section 501(c)(3) organizations) ought to be permitted to carry on related activities without adverse tax consequences unless such activities deflect the museum from its tax-exempt purposes. This principle should be applied to partnership and joint venture activities in which tax-exempt organizations participate. That is, IRS enforcement activity should be concentrated on making sure that tax-exempt organizations are meeting their tax-exempt purposes.

TREASURY DEPARTMENT PROPOSALS

Increased Reporting

We support more detailed reporting to confirm the correctness of the "substantially related" test, and to improve enforcement and compliance. We are concerned, however, that enhanced reporting not become a pretext for collecting a wide variety of data that has little or no connection to the relatedness issue.

The data collection effort must be very narrowly targeted towards such questions as the kind of royalty income earned (i.e., publications involving the museum's collection or logos on household items), and issues of management and control between the organization and its subsidiaries, partnerships and joint ventures, if any.

Allocation of Expenses

The need for new allocation rules depends, in large part, on whether the UBIT rules are changed. If the UBIT rules change, the current allocation rules may be inadequate. In any event, changes should be adopted only after consultation with museums and other tax-exempt organizations. Moreover, any such changes should recognize that tax-exempt organizations (if properly monitored) are motivated by very different considerations than commercial organizations. Therefore, the strict allocation rules applicable to commercial organizations motivated solely by profit-maximizing goals are not appropriate to tax-exempt organizations that are motivated equally to achieve goals of quality, scholarship and education.

We do support the Treasury Department recommendations to increase the specific deduction for unrelated business from $1,000 to $5,000, and to continue to rely upon the fragmentation rule. The increase in the deduction will ease the administrative burden of small museums. The fragmentation rule is the most complete and thorough test of relatedness. Although it can be burdensome, we believe the definitiveness of its results justify the burden.

Convenience of Members; Royalty Income

We do not believe changes to these rules should be considered until the IRS obtains more data. Even if the consideration of changes is advisable, more precise rules will be necessary to avoid any overreaching.

Subsidiary and Affiliate Income; Partnership and Joint Venture Allocations

We do not believe any changes should be considered until the IRS obtains more data. Moreover, any such consideration should give careful thought to the fiduciary obligation of officers and directors to pursue subsidiaries, affiliates and partners if such activities promise a significantly greater return than more passive investments.

Passive Investment Income of Social Welfare Organizations; Research Funds

We express no opinion on these issues.

ENDOWMENT INCOME TAX

The Ways and Means and Joint Committee on Taxation staff pamphlet on revenue raising options includes a proposal to impose a 5% excise tax on the investment income of section 501(c)(3) organizations. The rationale for the proposal is that all organizations that benefit from government expenditures should participate in the effort to reduce the federal deficit. The option paper acknowledges, however, that the beneficiaries of tax-exempt organizations will be hurt as a result of the reduction in funds available for programs. These dry pro-and-con arguments do not capture adequately the real impact of the proposal upon tax-exempt organizations nor the role of such organizations in serving public needs.

The AAM survey indicated that endowment income (which is essentially equivalent to investment income) represented between 10 and 20% of annual financial support. In the main, this income is used to fund museum operations. It is critical to the fulfillment of the tax-exempt purpose of the museum. Any reduction in investment or endowment income will reduce on a dollar for dollar basis the programs of the musuems. This means shorter hours of operation, fewer exhibits, and reduced outreach programs for the members of the community with the least access to museums.

The basis for conferring tax-exempt status is to encourage non-governmental organizations to undertake activities in the public interest. Museums support vigorous enforcement of the tax-exempt rules and loss of tax-exempt status for any organization that fails to act in the public interest. We believe strongly, however, that to impose an excise tax upon organizations that are acting in the public interest is to establish a precedent that will cause long term harm to our country. A tax will create permanent uncertainty in the minds of employees, beneficiaries and benefactors about the ability of tax-exempt organizations to commit all their resources to accomplishing the goals for which the organizations were established. Inevitably, the human and financial resources necessary to accomplish these goals will shrink. The result will be, in the case of museums, a society that knows less about its past and thinks less about its future. We suggest that such a society is ill-equipped to meet the responsibilities of freedom and democracy.

STATUS OF CHARITABLE CONTRIBUTIONS TO CULTURAL ORGANIZATIONS

As 1987 passed the mid-way mark, museums are beginning to see some of the negative effects of the 1986 tax bill that were predicted by economists. Although comprehensive evidence is not yet available, anecdotal information suggests that changes in the tax code, affecting appreciated property and the cost of giving, are already having a negative impact on museums. In a western city, the art museum lost an expected donation of a major painting because the donor perceived a loss of tax advantage through inclusion of appreciated property in the alternative minimum income tax. In a New England city, a major trust advisor has counselled his clients to withhold donations until the end of the year when the alternative minimum tax calculations can be made and effects on taxable income can be determined. A mid-Atlantic area decorative arts museum, which for the last two years has received over 195 donated objects annually, has received only 21 objects to date in 1987, with over half the year gone.

For 1986, the American Association of Fund-Raising Counsel (AAFRC) reported that for the first time in 10 years, corporate giving slowed to a marginal increase from the prior year. Another recent report by the Conference Board, a business research organization, showed that corporate contributions in 1986 actually declined for the first time in 15 years -- by 2.5 percent. Although this trend was not evident specifically in the cultural area, there is every reason to expect the same impact will manifest itself with respect to cultural institutions.

It is true that individual giving increased in 1986. However, museum development officers believe the figures are misleading as a result of the end of the year rush of donors to take advantage of the lower cost of giving available in 1986. The same phenomenon was experienced in other areas of the economy, such as accelerated corporate re-organizations due to the increase in the capital gains tax rate. Absent the effect of the unusual occurrence of rates dropping at year-end as happened in 1986 and as is expected to happen in 1987, we believe individual giving also would show a levelling-off if not a decline.

CONCLUSION

Museums, as well as other section 501(c)(3) organizations, have been buffeted by many changes in the tax law in recent years. Changes in the tax rate structure and the appraisal standards have created substantial uncertainty in the museum community. The inclusion of gifts of appreciated property in the minimum tax and the elimination of the deduction for non-itemizers have already begun to reduce museum support. While the full impact of any one of these, let alone all of them, is not yet known, the potential for significant harm to museums is clear. Adoption of another set of rule changes without careful examination of the impact of recent changes as well as the potential impact of new changes will increase the likelihood of undermining the already precarious financial stability of museums, as well as all other nonprofit organizations.

In conclusion, we fully support the Treasury proposal to increase the collection of data. We feel equally strongly, however, that the other proposals must await the results of this collection effort. This risk of precipitous action is too great to do otherwise.

Sincerely,

Edward H. Able Jr.

Edward H. Able, Jr.
Executive Director

cc: Russlyn Guritz

APPENDIX I

Group	Operating Budget (Millions)	Earned Income As % of Total Support	Private Support As % of Total Support	Public Support As % of Total Support	Endowment Income As % of Total Support	Unrelated Business Taxable Income
1	$11.8 +	32%	14%	31%	16%	Yes
2	8.0 to 10.2	32%	26%	19%	21%	Yes
3	3.5 to 5.7	20%	28%	37%	13%	Yes
4	1.5 to 3.2	34%	27%	26%	9%	Yes
5	.7 to 1.4	30%	32%	26%	12%	No
6	.3 to .65	39%	31%	19%	11%	No
7	.14 to .28	31%	35%	11%	23%	No

Definitions

Earned Income includes admissions and auxiliary service income such as income from restaurants, museum shops and parking lots (see testimony of Willard Boyd on behalf of AAM delivered to Oversight Subcommittee on June 26, 1987).

Private Support includes gifts, contribution and donations from individuals, corporations and foundations (in addition, some institutions have included admissions fees in this category).

Public Support includes all federal, state and local government support.

Chairman **Pickle**. Mrs. Blanton, will you give us your comments in writing to the committee?

Ms. **Blanton**. Yes.

[The information follows:]

American Council for the Arts Response to Treasury Department's Recommendations on Unrelated Business Income Tax

Recommendation: (1) More detailed reporting is needed to improve enforcement and compliance.

Response: CA would recommend that the Internal Revenue Service report aggregate data from the 900 T form without disclosing individual organizations.

Recommendation: (2) Reexamine the existing exemptions from the relatedness standard for volunteer-operated businesses, and commercial activities carried on for the convenience of groups such as patients or students.

Response: The American Council for the Arts believes that the volunteer-operated organizations associated with a nonprofit arts institution were created and primarily exist to serve the arts institution to bring the arts to the general populace of this country. Many of these organizations are formed as a support system for the arts institution providing such serves as educating the public on arts scholarship; volunteer services to the institution, i.e. typing assistance, ushering, etc.; and to build community support for the institution to rely less on government support.

Recommendation: (3) Clarify rules for the allocation of expenses so that relationships between an organization's exempt functions and its unrelated activities are more appropriately reflected. Increase the specific deduction from unrelated business income from $1000 to $5000.

Response: While many arts organizations are not involved in unrelated business activity, ACA would support efforts to clarify an organization's exempt functions and its unrelated activities. A clear definition would be valuable. ACA would also support the increase in the specific deduction.

Recommendation: (4) Broaden the definition of "controlled subsidiary" to include those in which an exempt group holds more than a 50% interest in stock value or voting power. Aggregate the activities of an exempt organization and its subsidiaries to determine the primary purpose of that organization.

Response: ACA is not aware of any arts organizations that fall under this circumstance and therefore is unable to respond.

Recommendation: (5) Passive investment income should be taxable for social welfare groups [501(c)(4)s] unless the income is permanently set aside for charitable purposes.

Response: Not applicable.

Recommendation: (6) Examine the definitions of research and requirements for its dissemination.

Response: Not applicable.

Recommendation: (7) Current restrictions on allocations between taxable and exempt partners may not be adequate.

Response: ACA is not aware of any arts organizations that fall under this circumstances and therefore is unable to respond.

Chairman **Pickle**. I thank you. Your organization has meant a great deal to the cultural improvement and happiness of America, and it is important. I don't sense any real competition in your particular area with the private for-profit field. Overall we have got to try to hit a balance on this subject and improve it.

I think if we could get the UBIT present law really enforced, we might solve a lot of our problems. But it hasn't been enforced. There is no enforcement effort per se at the IRS, and we have looked the other way for 20 years and a lot of abuses have come up in the meantime.

It is a problem we must face and your testimony today will make a real contribution to the committee as we consider it, so we thank you very much.

Mr. **Boyd**. If I might add something, last summer about this time I was called upstairs in the museum and there was a lady there, a good friend of you and Mrs. Blanton, with her granddaughter. She wanted to go to the cafeteria because she had brought the granddaughter over to go to the museum and aquarium and planetarium, and they are isolated. She said the last time I was here, I went to the cafeteria; they tell me there is no cafeteria.

I said there is no cafeteria because we couldn't afford to maintain it. We have had to go to vending and other kinds of fast service.

So I then had the distinction of taking Mrs. Lyndon Johnson and her daughter down to the fast food vending service. She had come there looking to spend the day. So I must say that even on our services we are forced to retrench.

Chairman **Pickle**. If I see Lady Byrd this weekend, do you have a cafeteria that she can use now?

Mr. **Boyd**. No, but we have some vending.

Chairman **Pickle**. She was in Washington with two of her granddaughters and I was privileged to take her to the House dining room, which you might classify as a fast food service, and she is a tremendous person. I am glad you mentioned her.

Thank you very much.

Now, the next panel will be Mr. William Blair, chairman of the board, representing the American Arts Alliance. I believe this will be the last panel for the day. Let's hope we can end on a positive note and short duration.

Mr. Blair, will you proceed, sir?

STATEMENT OF WILLIAM P. BLAIR, CHAIRMAN OF THE BOARD, AMERICAN ARTS ALLIANCE, ACCOMPANIED BY C. WILLIAM STEWART, MANAGING DIRECTOR, ARENA STAGE; EDWARD PURRINGTON, ADMINISTRATIVE DIRECTOR, WASHINGTON OPERA; AND EDWARD WOLFF, GENERAL MANAGER, ALABAMA SYMPHONY ORCHESTRA

Mr. **Blair**. Thank you. I appreciate the opportunity to be here.

I am William Blair, attorney, practicing law in Ohio, and I am privileged to be chairman of the American Arts Alliance, the national advocacy organization for nonprofit performing and exhibiting arts groups. Constituent organizations of the American Arts Alliance are opera, dance, theater companies, art museums and symphony orchestras, all of whom qualify for tax-exempt status because of their educational mission.

I am accompanied by C. William Stewart, managing director, Arena Stage; Edward Purrington, administrative director, the Washington Opera; and Edward Wolff, general manager, Alabama Symphony Orchestra. We will all be expanding upon the testimony, Mr. Chairman, which we have previously submitted for the record to the subcommittee.

In addition to our regular performance schedule, our constituents provide outdoor concerts, performances in schools and senior citizens homes, and other activities that bring cultural vitality to communities across the country. But the cost of these activities are high.

I want to discuss the system of financing that make these entities possible, with emphasis on earned income—the focus of today's deliberations. Arts institutions rely on a three legged system of financial support, philanthropic contributions, government moneys, and earned income. I might say we have a great deal of concern in all three areas.

In the area of philanthropic contributions, we are very concerned about the effects of the recent Tax Reform Act, especially as it deals with charitable contributions.

On the subject of government moneys, as was mentioned in the previous panel, when President Carter left office the Federal Government was supporting the National Endowment for the Arts at the rate of $159 million. You gentlemen and ladies of the House yesterday, I believe, passed an appropriation for the National Endowment for the Arts of $166.3 million, or $1 million more than last year. So you can see those moneys have not increased and that in real dollars, there has been a decrease in Federal support for the arts.

The third leg of our system of financial support is earned income. When it comes to earned income, performing groups generate the bulk of moneys received through ticket sales. This income as a percentage of aggregate field income in the most recent fiscal year made up the following amounts:

In the dance field, earned income was 55 percent.

In professional theater, 49 percent.

In opera, 43 percent.

In orchestras, 41 percent.

The ability to perform and offer reasonably priced tickets to the public is at the heart of our member institutions' missions. But as you can see, ticket sales cover only half of the cost of a performance. The remainder is made up in other areas, including additional income producing activities. In an effort to learn more about these activities, the alliance has surveyed its membership. The survey enjoyed a a response rate of about 52 percent, or 183 groups.

We found that in various fields of activities—and let me go down the list for you—60 percent of the groups responding reported gift shop sales, with median incomes of about $30,000.

Facilities rentals were done by 46 percent of the groups responding, with median income of $10,200.

Program advertising, 43 percent of our groups did this with a median income of $25,000.

Catalog sales, 27.8 percent of the groups, with a median income of $20,000.

Costume rental, 23.3 percent of the groups did this with a median income of $2,926.

Set rentals, 22.8 percent were engaged in this activity with a median income of $4,500.

Equipment rental, 21.1 percent, median income $1,350.

Travel services, 18.3 percent, median income $9,081.

And mail list rentals, 13.3 percent, with a median income of $900.

Book publishing, recording and broadcast royalties were done by less than 10 percent.

As important as these activities are, the majority of the survey respondents earn less than $75,000 from them and 25 percent of all respondents earn less than $25,000.

These activities are essential in not only helping to fulfill the mission of the organization, but in generating money needed to run other necessary programs, such as outreach activity that is important to the groups and the community, but which does not and cannot generate income.

Additionally, these activities help to heighten public awareness and community visibility of the institutions and to attract membership.

A number of activities that arts groups engage in are exempt from UBIT. They include royalties from recording and broadcasts, activity such as concessions and gift shop sales conducted exclusively by volunteers, income on endowments and activity such as food services arrived on for the convenience of members and visitors.

The survey shows that the activities unrelated to the groups' mission included program advertising, and facility rentals, gift shop sales of unrelated items, sale and rental of mail lists, sale and rental of art.

In conclusion, we found that the survey reveals that 40 percent of respondents had been audited by the IRS but only 19 percent had been audited for unrelated business income. Of those audited for UBIT, 71 percent received a favorable ruling and only 3 percent had received an unfavorable ruling. Twenty-six percent were pending a final ruling.

I would now, Mr. Chairman, like to turn to my colleague, C. William Stewart, managing director of the Arena Stage in Washington.

[The statement of Mr. Blair follows:]

TESTIMONY SUBMITTED

by

WILLIAM P. BLAIR

for the

AMERICAN ARTS ALLIANCE

The American Arts Alliance is pleased to submit testimony to the House Ways and Means Oversight Subcommittee as it begins a review of income-producing activities conducted by nonprofit organizations. The Alliance, established in 1977, is a consortium of over 350 professional nonprofit performing and exhibiting arts institutions in the fields of theater, dance, opera, symphony orchestras and the visual arts. Central to the Alliance's purpose is the establishment of a national public policy for the arts.

The Alliance welcomes the opportunity to participate in these oversight hearings and applauds the subcommittee's efforts to examine a number of critical areas, including: (1) the tax law governing the income-producing activities of nonprofit institutions; (2) the extent to which such activities may be related or unrelated to a nonprofit organization's mission; and (3) current compliance on the part of nonprofits with Unrelated Business Income Tax (UBIT) regulations. The American Arts Alliance believes that in general, current law regarding earned income is fair and equitable and that no major changes in it are required. We also believe that nonprofit arts institutions are in compliance with the present UBIT regulations and do not compete with for-profit entities, points we will later address in more detail.

In order to help the subcommittee in its oversight responsibilities, our testimony will profile the role of nonprofit arts institutions in our society and outline the rationale behind government support of this role. It will also describe the delicate system of financial support on which arts institutions are based, and the importance of earned income to that system. Finally, it will highlight the types of income-producing activities nonprofit arts institutions most commonly employ to generate essential earned income.

The Role of Arts Institutions in American Society

A central goal of nonprofit arts institutions is to educate their audiences. While the arts do not educate in the conventional manner associated with colleges and universities, they do educate by enhancing our awareness and understanding of our world and of ourselves. They act not only as an educator, but also as a recorder and interpreter of history. An exhibition of Impressionist paintings, for example, may teach about the evolution of visual art from the 19th century to today's contemporary forms, but it also teaches about color, beauty and light. The recent Jacob Lawrence exhibit at Washington D.C.'s Phillips Collection not only offered similar insights about visual arts technique, but through its depictions of the Civil War, the Depression, life in Harlem, and American race riots, chronicled the historical experience of black Americans. From a performance of *Antigone* we learn not only of the history and values of classical Greece, but of the universality of human courage and moral imperatives as well. In a similar vein, Repertorio Espanol in New York City includes among its productions plays documenting the experiences of Hispanic Americans in the United States. The music of Aaron Copland and the dances of Agnes DeMille can in many ways better convey the spirit and vitality of the American frontier experience than thousands of pages of formal history.

Nonprofit arts institutions also strive to insure broad accessibility to the arts for all Americans. Americans believe that the arts should be enjoyed by all citizens. To insure that they are as widely available as possible, arts institutions employ a variety of strategies: varied ticket prices that accommodate audiences of all income levels; discounted tickets for students and senior citizens; free performances in city parks and local schools; free lecture or film series' held in art museums and offered to the general public; and donations of time by professional artists to work with talented young students.

Rationale for Government Support of Nonprofit Arts Institutions

Federal government support for the arts has taken essentially two forms: indirect support provided through the tax code and direct support provided through grants from the National Endowment for the Arts. Only in the last twenty years, since the establishment of the Endowment, has direct support been given to arts institutions. It has catalyzed an enormous explosion in the institutional base of the arts, something discussed at greater extent in the following pages.

Indirect support, however, through the tax code has a much longer history. The government has granted nonprofit organizations tax-exempt status in recognition that their activities are best carried out by the private sector with only minimal government involvement.

State and local governments, since our Republic's earliest days, have exempted nonprofit cultural institutions -- together with religious, charitable and other educational institutions -- from certain tax laws. They have done so because the activities of these organizations have been deemed beneficial to both the individual and the general public and are therefore deserving of government support. Also implicit in the law is the assumption that certain essential public service functions are best fulfilled by the private sector. This concept was formally incorporated into federal policy by the Revenue Act of 1913 which exempted nonprofit income from taxation. Further, by introducing the concept of deductibility to encourage individual philanthropy in the 1917 Revenue Act, the federal government underlined the unique value of nonprofit organizations to American society.

Through performances, exhibitions and other related activities, nonprofit arts institutions qualify for tax-exempt status as educational institutions. The Internal Revenue Service (IRS) defines education as the instruction of an individual for purposes of improving or developing his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

Another characteristic that separates nonprofits from commercial entities is that no part of a nonprofit arts institution's net earnings may benefit any private shareholder or individual. This point is the crucial difference between income-producing activities carried out by nonprofit organizations and those conducted by commercial concerns. The earnings of nonprofit arts institutions are reinvested in projects which further their aims --be they low ticket prices, productions of new works by composers or choreographers, revivals of classical repertoire, purchases of new paintings, or the training of young artists. Conversely, the earnings of a for-profit organization are distributed among shareholders for private gain.

Professional arts organizations, in fulfilling the mission for which they were granted tax-exempt status, do not compete directly with for-profit businesses. Generally, there are no commercial operas, symphony orchestras, art museums or dance companies. There are commercial theaters, but they differ substantially from nonprofit ones. Commercial theater seeks to produce a play that will run for an extended period of time and provide investors with a financial profit. In contrast, the nonprofit theater is structured to produce a body of work that provides an educational and aesthetic experience for its audiences, and in so doing, advances the art form. Escalating costs have caused a decline in the commercial theater so that the experimentation and presentation of new work is now solely in the hands of nonprofit theater. Additionally, if a particular nonprofit production enjoys financial success, those profits help subsidize further research and development of new works and are not returned to investors.

The System of Financial Support of Nonprofit Arts Institutions

The survival of nonprofit arts institutions is dependent upon an intricate network of diverse funding sources, ranging from income-producing activities, private contributions from individuals, corporations and foundations, and support from federal, state and local governments. This pattern of financing is uniquely American. The loss or substantial alteration of any one component would threaten the entire system of financial support.

Private-sector support for cultural activities has grown from between $200 to $300 million in the mid-1960's to $5.83 billion in 1986, according to the American Association of Fund Raising Counsel. However, as a percentage of total philanthropic giving, it has remained relatively level since the late 1970's. In addition, private giving to cultural institutions already ranks next to last as a percentage of total philanthropic contributions, well below contributions to religious groups, formal education organizations, and the health and human services. Given these priorities, arts organizations cannot assume they will be able to advance or even maintain their share of contributions.

Federal support, provided primarily through the National Endowment for the Arts, has remained static during the 1980's and in some arts disciplines has actually decreased. At the same time, federal funding for other educational and social services programs has declined. Thus, arts organizations are forced into increased competition with other nonprofit institutions for state and local support as well as for contributions from the private sector.

In addition, recent changes in the tax laws, we believe, are likely to have a negative effect on private contributions. Rate reductions, which were included in both the 1981 Economic Recovery Act and the 1986 Tax Reform Act, generally weaken incentives for charitable giving. Changes in the federal estate tax, also incorporated in the 1981 law, reduced the tax savings from bequests to charitable organizations. Elimination of the non-itemizer's tax deduction and the inclusion of gifts of appreciated property in the alternative minimum tax will also negatively affect charitable giving although it is still too soon to estimate the total loss. The appreciated property provision is expected to be particularly significant in the arts field because art museums rely on these gifts to build and maintain their collections. In fact, gifts of appreciated art works account for an average of 80% of an art museum's collection. Further, appreciated assets, usually in the form of stock and other financial investments, are important to the endowment and building campaigns of performing arts groups.

Faced with lack of growth in both direct government subsidies and private contributions, arts organizations must rely increasingly on additional sources of earned income, other than ticket sales, to meet operating expenses. If these earnings decrease or their value is reduced, ticket prices and admission fees to arts events would have to be increased, artistic quality would suffer, the number of performances or exhibitions would drop; outreach and educational programs would be cancelled; and staffs would be cut or artists' salaries lowered.

Earned Income

1. The Importance of Earned Income

Earned income helps support the services arts institutions provide to the public. The Pennsylvania Academy of Fine Arts in Philadelphia, for instance, uses a portion of its earnings for outreach programs to senior citizens, schools, nursing homes and the general public. The Evansville Philharmonic Orchestra in Indiana generates and uses its earned income to present local and tri-state youth concerts to 12,000 students annually. The Milwaukee Symphony uses concession income to support its summer concert series; set and costume rentals to other companies not only makes the Boston Ballet less dependent on contributed revenue, but also enables smaller dance companies to produce ballets otherwise beyond their reach. Earned income allows the Tri-Cities Opera in Binghamton, NY to offset the expense of training young singers, while the Amon Carter Museum in Fort Worth, TX uses part of its earnings as a revolving fund for educational publications.

2. Extent of Earned Income

The constituent organizations of the American Arts Alliance are supported to a very large degree by earned income. In their most recent fiscal year, for example, dance companies derived 61% of their aggregate annual operating budgets from earned income, as compared to 39% from all other sources. The ratio for nonprofit theaters during the same time period was nearly identical: 62% earned, 38% unearned. Orchestras averaged 61% earned to 39% unearned, while opera companies received slightly more from unearned sources (51%) than earned (49%).

But it must be emphasized that in all performing arts disciplines, the vast majority of earnings result from performance income. In dance, performance and ticket income, again for the most recently completed fiscal year, accounted for 55% of all income, with only 6% of the total budget coming from other earned income sources. In theater, performance income accounted for 49% of all income with only 13% of the total budget coming from other earned income sources. For operas, performance income accounted for 43% of all income, with only 6% of the total budget coming from other earned income sources. Lastly, for professional orchestras, performance income accounted for 41% of all income with 20% of the total budget coming from other earned income sources. While it is estimated that art museums, on average, earn only about one-third of their annual operating budgets, the performing arts clearly depend on earnings.

Although performance income provides a significant portion of arts institutions' budgets, it does not begin to cover their total costs. A recent Theatre Communications Group survey indicates that a ticket to a nonprofit theater performance is sold at less than half its real value: 51% of its cost must be covered by other means. In the dance field, 55% of a ticket must be covered by other means, and for an opera ticket the figure is 57%. Similarly, the Association of Art Museum Directors estimates that it costs a museum $16.25 to service one visitor: yet many museums have no admission fees and those that do rarely charge more than $4 or $5.

In order to meet the increasing public demand, arts institutions' operating costs have risen dramatically. From 1982 to 1986 there was a 49.6% increase in symphony orchestra expenses, yet only a 46.9% rise in overall income. Theater operating costs during the 1985-86 season increased 7% over the previous year, well ahead of the inflation rate. The opera field reported a 6.9% increase in operating expenses last year while dance companies recorded an average increase of 12.5% over the past three years. A survey conducted by the Association of Art Museum Directors indicates that from 1985 to 1986, art museums suffered steep rises in a number of crucial areas including a 40% increase in curatorial and exhibition costs, and a startling 52% increase in acquisition expenses. This latter figure is especially significant in light of the fact that the number of art works purchased dropped by 14% between 1985 and 1986. To meet these cost increases, earned income is essential.

The difference between the actual cost and the price of admission, which clearly must be kept low in order to provide the broadest public participation possible, has to be made up from other earnings as well as from grants and private contributions. As already pointed out, earnings from sources other than performance income may appear to constitute a relatively small percentage of the budgets of most arts institutions, but they are nevertheless invaluable to institutions' overall financial health.

3. Sources of Earned Income

In preparation for these hearings, the American Arts Alliance conducted a survey of its membership to determine what sources, other than ticket sales, generate earned income. 183 organizations, or 50% of the Alliance membership, responded. The survey reveals that most institutions undertake income-producing activities as a way of covering their artistic and public service expenses. 60% of the survey respondents reported income from gift shop sales; 46% from facilities rental; 43.4% from program advertising sales; 27.8% from catalogue sales; 23.3% from costume rental; 22.8% from set rental; 21.1% from equipment rental; 18.3% from travel services; and 13.3% from the sale or rental of mailing lists. Less than 10% of the survey respondents received income from book publishing, recording and broadcast royalities, or coat room services. As important as income-producing activities are, the majority of survey respondents earned less than $75,000 from them, and 25% of all respondents earned less than $25,000.

As the survey results show, the bulk of the income-producing activity of nonprofit institutions takes place in the area of gift shop sales. Usually sales from such stores directly relate to the institution's tax-exempt mission in that they further the educational purposes for which the organization was formed. The sale of a book on Mozart's contribution to music or a tape of Beethoven's Fifth Symphony, for instance, allows the symphony-goer to take home a part of his evening's experience. The sale of T-Shirts, mugs and posters bearing the logo of a theater, dance or opera company help create not only public awareness of the institution's existence and purpose, but enhance public interest in the arts in general. The sale of an opera libretto can help audiences better understand the subtlety and nuances of a production, just as the sale of note cards, facsimiles of original art works and other mementos in a museum gift store can help prolong a visitor's awareness, appreciation and understanding of the objects he has seen.

Gift shops run by nonprofit arts institutions may contain other items that are not related to the organization's main purpose. But it must be kept in mind that the gift shop does distinguish between the various objects it sells by applying to each of them individually the IRS's relatedness standard. Nonprofit arts groups do pay tax on income from the sales of unrelated objects under the existing UBIT law.

Other activities crucial to nonprofit and performing arts groups are numerous. Set and costume sales and rentals benefit both parties to the transaction by providing economies of scale at a time of dramatically rising production costs. The set which Opera/Columbus rented for its production of La Traviata would have cost $150,000 to produce new, but when rented from another opera for $6,000, resulted in much-needed earned income for the lending company and dramatic savings for Opera/Columbus. Chicago's Goodman Theatre rented costumes from the American Conservatory Theatre in San Francisco for its production of Sunday in the Park with George and in doing so saved $10,000.

Many groups sell broadcast and recording rights to their productions in order to bring performances to audiences all over the country. The royalties that result help them to continue their outreach programs and activities. In like fashion, many art forms undertake impresario activities, inviting outside groups and performers to use their facilities in an effort to broaden audience perspectives of the art form.

Food services make eating arrangements more readily available to visitors of museums as well as performing arts events. Such services provide groups and individuals with an added convenience and the freedom to extend their stay as long as possible.

Advertising income helps defray the costs of printing the programs, magazines and other publications that are an integral part of any institution's service to its audiences. These materials are the principal means by which institutions inform and educate their audiences on activities and current trends in the field. Programs distributed at performing arts events are additionally necessary as the means by which performing arts groups comply with union requirements to credit performers. For arts groups, such publications are an essential tool of the trade and their expense is an unavoidable cost. Printed program advertising for several opera companies accounts for approximately 8% to 10% of total earned income.

In general, advertising in these publications generates fully taxable income that nonprofit arts institutions report under the UBIT laws. However, exceptions to this rule do exist. Nonprofits are not liable for UBIT on income generated by activities conducted by volunteers, or on advertising activities whose commercial benefits are inconsequential.

Finally, specialized travel programs make up another category of income-producing activities that some institutions offer to their members. These trips, which are designed to focus on the cultural aspect of the place visited, are initiated by the institution's staff or directors. But in most cases the detailed logistical planning and organization is handled by independent travel agents, especially when the tour involves foreign travel. The programs are used primarily to meet member expectations; expand membership; develop new supporters; cultivate future contributors; and provide an "extra touch" to regular member services. Because these programs generate little money and in some cases actually lose money, sponsoring institutions usually require participants to make a charitable contribution on top of the actual travel costs.

Another area in which the committee has indicated an interest is endowment income. Endowments are a critical means by which institutions provide for their long-term stability. These funds, in helping to assure institutions an on-going source of income, act as a buffer against fluctuations in yearly patterns of private giving and government support. Endowments and their interest income help support projects of significant expense and are pivotal in funding those projects which are the mainstay of a group's operations -- maintenance, utilities, conservation, security, etc. -- but that because of their unglamorous nature, attract little private support.

The National Endowment for the Arts, through its Challenge Grant program, recognizes the importance of endowments to nonprofit arts institutions. The arts endowment encourages their development for not only essentially operations support, but also for the signal endowments send of a group's permanent place in the fabric of its community.

According to the Alliance survey, the number of arts institutions reporting unrelated business income has slightly increased over the past five years. In 1981, 9.8% of the respondents filed a 990T form with the IRS, 12% in 1982, 13.1% in 1983, 14.8% in 1984 and 15.8% in 1985. The most commonly reported unrelated income areas are program advertising, gift shop sales and concessions.

Most respondents had never been audited by the IRS for unrelated business income. Of the 35 institutions that reported such audits, 25 were found by the IRS to be in compliance with the law, and 9 were awaiting a final ruling. Only one institution responded that the final outcome was unfavorable.

When asked if the IRS had issued a ruling within the past five years regarding their income-producing activities, 90.7% of the respondents answered no. Five respondents answered yes, but only one reported that the ruling had a significant effect on the organization's income.

These statistics show that arts organizations are complying with the current law and regulations. Moreover, they demonstrate that the major portion of arts institutions' earned income is directly related to their tax-exempt purpose and is used to carry out their public mandate to serve the widest possible audience.

Growth in the Arts

The arts field has grown tremendously in the past 20 years. Not only has there been a proliferation in the number of institutions in all arts disciplines, but a significant growth in arts audiences as well.

1. Institutions

In 1966, there were only 37 professional dance companies, primarily located in New York City, today there are 240 based throughout the nation. The number of professional symphony orchestras has almost tripled from 58 in 1965 to 165 in 1986. Today there are 98 American opera companies where only 27 existed in 1965. A handful of professional nonprofit theaters has multiplied into more than 400, located in every state of the union. More than one-third of a national sample of art museums have been founded since 1960; the most recent survey of the museum field, conducted in 1979, revealed that America boasts 600 art museums while another 325 museums have substantial art collections.

2. Artists

Similarly, there has been an increase in the number of American artists. Between 1970 and 1980 the artist labor force grew by 47%. By 1985, 1.4 million people were employed in artists' occupations. The growth rate in the first three years of the 1980's has been estimated at 6.2%; if that trend continues for the rest of the decade, the artist population of this country will reach 2 million by 1990. The growth in the number of arts institutions throughout the country has created new "local" markets for those artists.

3. Audiences

Most importantly, there has been a phenomenal expansion in the audiences served by these artists and institutions. 14.8 million people attended nonprofit professional theater performances in 1986 as compared to one million in 1965. Between 1965 and 1985, attendance at orchestral concerts rose from 10.5 million to 22.7 million. Over six million persons attended opera performances during the 1984-85 season, two million more than during the 1969-70 season. The audience for dance has grown from one million in 1965 to 16 million today. Large museums in major cities are estimated to attract between 500,000 to 2 million visitors each year.

There are indications that even larger potential audiences exist. According to the National Endowment for the Arts' 1982 Survey of Public Participation in the Arts, 63% of those interviewed wanted to attend performances or exhibitions more often. Based on those findings, an estimated 30 million people would like to attend more classical music performances; 40 million want to attend more theater; 19 million want to see more dance; 51 million would like to visit art museums more often and there is a potential audience of 65 million for opera and musical theater.

Conclusion

The Alliance believes there should be no fundamental change in present law related to income-producing activities conducted by nonprofit organizations. The law is fair and throws a net of tax protection around activities central to the purpose of such organizations, thereby encouraging the fulfillment of their public service mission without going beyond that mandate.

In specific regard to UBIT, we believe that tax should be paid on income generated by activities that do not promote the purpose for which arts institutions are granted tax-exempt status. We support full compliance with the statutes and IRS regulations and believe penalties should be imposed on organizations that do not comply. National organizations representing nonprofit institutions, such as the Alliance, should increase efforts to keep their memberships fully informed of regulatory changes to further insure complete compliance. In addition, allegations of unfair competition should be thoroughly investigated on a case by case basis.

The Alliance wishes to offer the committee our full cooperation and support as this oversight review continues. But we would emphasize again that we find no compelling reason for Congress to change the basic nature of a policy that seems to be working well. As noted in our survey results, IRS audits of arts organizations' income-producing activities were overwhelmingly favorable, indicating a strong adherence to the UBIT laws by nonprofit arts institutions. The survey further demonstrated that the vast majority of earned income is directly related to the central purpose for which arts organizations are exempt from taxation. We have also attempted to describe why those earnings are of such significance to the financial stability of the arts field. Current law regarding related and unrelated earnings contributes to that stability and is consistent with longstanding government encouragement of a wide range of philanthropic endeavors. We would urge this committee to thoroughly evaluate the contributions that nonprofit institutions make to American society before instituting changes that could dramatically alter the way in which those institutions function.

Mr. STEWART. Thank you. I am William Stewart, managing director of Arena Stage. We are completing our 36th year of operation as the Capital City's foremost resident professional theater. We produce an eight-play season in our two principal theaters, Kreeger and the Arena. The Old Vat provides a home for Stephen Wade's Banjo Dancing, which was, incidentally, featured this past Tuesday on Channel 26 public television here in Washington.

This year, we have given 338 performances, playing to more than 300,000 people. Our top ticket price is $24.75 with tickets ranging from $5 to certain performances for students to group and senior citizen performance discounts between $7 and $12.

Arena has an outreach company—the Living Stage—which performs in its theater located at 14th and T Streets Northwest here in Washington. It is an improvisational theater, working with children, youths in trouble with the law, incarcerated men and women, and the elderly. During its two decades of work in Washington, Living Stage has brought new hope to thousands of the city's neediest people.

Arena Stage and Living Stage budget this year is $7,350,000. Ticket sales provide 55 percent of this expense. Other earned income totals $765,000, providing approximately ten percent of the expenses of our operation. The balance of our expenses is provided, 35 percent, from contributed income.

The principal sources of other income to Arena Stage are concession sales, food and beverages at our performances of about $98,000. Ticket sales service charges of $80,000. Service contracts for Living Stage's work of $78,000. Workshops, fees and tuitions to Living Stage, $39,000. Rental of our auditorium principally to the Environmental Protection Agency, which is across the street from our theater, that is $4,000. Rental of props and costumes, $7,000.

We do have investment income of $169,000 and finally we have a new source of income which is the income from our endowment. We completed a $6 million endowment campaign last spring encouraged by a challenge grant of $750,000 from the NEA and this endowment this year will provide income of $276,000. All of this additional income is used to meet the overall expenses of producing our plays and providing our community services.

We do report this income in part 1 of the 990 form, line 11, of other revenue and line 5, dividends and interest. Arena has never been subject to UBIT.

Finally, I would like to point out that the budget for the work of our Living Stage company is about $550,000 and I would suggest that it is the use of this other income that makes possible the services of this important community program.

Thank you very much.

Chairman PICKLE. Thank you.

Mr. PURRINGTON. I am Edward Purrington, administrative director of the Washington Opera. Before assuming that position one month ago, I had been for 12 years the general director of the Tulsa Opera in Oklahoma.

The Washington Opera presents the fifth longest season of any opera company in the United States, in the past season performing 76 performances of eight operas in both the Opera House and Terrace Theatres at the John F. Kennedy Center, and playing to over 70,000 persons.

The world premiere of the opera Goya with Placido Domingo was produced by the Washington Opera last October and was carried on national television, therefore taking the Washington Opera to an audience of several million.

Our outreach efforts involve education programs for young and old, sponsored by our auxiliary, the Washington Opera Guild, and in conjunction with the Kennedy Center Education Department. These include open dress rehearsals for students; teacher training for recertification; lectures; demonstrations and seminars, and discount tickets for students, senior citizens and certain military personnel.

The operating budget for the opera this year has been $6.8 million; 46 percent of the budget has come from earned income. The components of earned income are ticket sales and that represents 94 percent of earned income, with additional income from the rental of sets, costumes, subtitles, miscellaneous ticket-handling charges, interest on investments and so forth.

Chairman PICKLE. Did I understand you to say that 94 percent of your income was from ticket sales?

Mr. PURRINGTON. Ninety-four percent of earned income is from ticket sales, that is correct.

The unearned or contributed income, which amounted to $3.7 million, came from foundations, individuals and corporations, from special events, Guild memberships and public grants. This involves a massive effort of volunteers, both board members, Guild members and many other dedicated volunteers.

I would like to specifically speak about the rental of scenery and costumes since this is an activity in which we engage a fair amount. The Washington Opera's investment in sets and costumes is extremely high. New scenery and costumes for a production will cost anywhere upwards of $250,000. Therefore, subsequent rentals of such items help very much to amortize this necessary investment.

For instance, the Washington Opera production of Madam Butterfly, which was new late in the 1960s, has been rented by more than a dozen companies returning over $90,000 to the company against an original investment of about $150,000. This is a very useful way of deriving income using our stock in trade and in no way competes with commercial enterprises.

There is a new dimension of production asset rental in the new discovery of surtitles, those popular projected translations of the opera text above the stage. The Washington Opera creates its own surtitles for each production this year at a cost of $40,000 and to be able to provide this service, which is in heavy demand on a rental basis across the country, helps us with additional income.

The Washington Opera Guild, a major auxiliary made up of many volunteers, carries on numerous activities to fulfill its obligation to support the opera in addition to the educational activities I mentioned. One such activity involves the selling of T-shirts, memo pads, the gift shop items with the logo of our organization, any small profit from this being turned over as a part of the annual Guild contribution.

The Washington Opera Guild also occasionally sponsors tours to other companies such as the Munich Opera or the Santa Fe Opera, and has consistently turned the management of these efforts over to a commercial travel agency, the sole benefit to the Washington Opera is the add-on contribution of *x* number of dollars which goes directly to the opera from each tour participant.

The Washington Opera does not receive any benefit from concessions at the Kennedy Center or from program advertising. At the Washington Opera we have been fortunate enough to see a marked increase in public and private support. This is not necessarily typical across the country or across the industry.

In my remaining comment, let me address my recent experience in an area that has been financially and psychologically ravaged by the results of the oil recession. I am speaking of Oklahoma, but the same goes for Houston, Dallas, New Orleans, et cetera. The State Arts Council of Oklahoma has been forced to slash its funding capabilities because of the decrease in oil revenues by more than 60 percent. There is serious question about the future of the State Arts Council.

Local business, while making a brave commitment to sustain the arts organizations in and for the community, is having a hard time picking up the slack from this drastic cut in state support. Another problem in such areas is the impact of heavy unemployment on ticket purchasing, especially the commitment in advance on season tickets, where there is much more of a wait-and-see attitude.

The performing arts have demonstrated that they are good business for their communities offering considerable employment, significant payment for goods and services. We want to keep the arts healthy and an integral part of our communities. But we need every resource of earned income to supplement the ever greater challenge to secure contributed income in order to sustain our organizations and serve our constituencies.

Thank you.

Chairman PICKLE. When you say you need every source of income that you can get, are you saying that you are engaging in a lot of activity, any kind of activity to get income?

Mr. PURRINGTON. No, sir, reasonable activities that are related to our principal mission, which is producing opera.

Chairman PICKLE. If I understood you, you said 94 percent of your income actually is from the sale of tickets.

Mr. PURRINGTON. That is right.

Chairman PICKLE. So any other income is very limited.

Mr. PURRINGTON. I am sorry, 94 percent of our earned income is from the sale of tickets.

Chairman PICKLE. I see.

How would—Mr. Wolff, you are from Alabama, do these figures compare with yours?

Mr. WOLFF. Yes, our earned income is virtually all from ticket sales, the earned portion of our revenue.

Chairman PICKLE. What about your income from the sale of T-shirts that you mentioned? You sell T-shirts.

Mr. PURRINGTON. This comes in as part of the contribution from the Washington Opera Guild. It is not a project that the Washington Opera per se engages in.

Chairman **Pickle**. Well, whatever it is a part of, is that part of your income? Is that unrelated income?

Mr. **Purrington**. It is related income.

Chairman **Pickle**. It is related; it is not unrelated. Do you pay any UBIT on the sale of T-shirts?

Mr. **Purrington**. No, we don't.

Chairman **Pickle**. Or books or trinkets and things you might be able to provide at intermission?

Mr. **Purrington**. No.

Chairman **Pickle**. You don't pay UBIT?

Mr. **Purrington**. No.

Chairman **Pickle**. Is that true in Alabama?

Mr. **Wolff**. Yes, any merchandise of that nature would only be that which we have, such as the Alabama Symphony advertised on the T-shirt and to promote the symphony, mugs, bumper stickers, so we consider that to be related income. We don't file a 990-T either.

Chairman **Pickle**. I started to ask you a question, Mr. Stewart, and I believe I have not asked you to give your statement. I am sorry I haven't done that.

Mr. **Blair**. Mr. Wolff you mean.

Chairman **Pickle**. I got the names separated. Which is Mr. Wolff?

All right, Mr. Wolff, you go right ahead. I am sorry I didn't ask you. We would be pleased to have your statement.

Mr. **Wolff**. I am Ed Wolff, general manager of the Alabama Symphony in Birmingham, AL. We are a regional orchestra and have been an orchestra since 1933, approximately 54 years. We are the official orchestra of the State of Alabama. Not only do we provide performances in Birmingham but travel throughout the State and also represent the State of Alabama at the National Tour Association Conference wherever it may be held.

In the last 4 years it has been held in Nashville, Atlanta, Reno, and this coming year we will be coming to Baltimore, MD. We go to virtually 25 cities throughout the State and in addition we provide education in the schools. This past year we taught approximately 800 young people, many from disadvantaged neighborhoods. We also provided about 25 youth concerts throughout the State to approximately 75,000 people.

In order to do that, we have a budget of approximately $3,300,000. Our earned income is virtually all from ticket revenue which represents about 38 percent of our revenue, 39 percent comes from the private sector in either contributions and/or projects that are voluntary projects, and the remaining is from governmental funding.

I would like to address briefly the passive income. Two years ago an old hotel was purchased by two well-known athletes, Kareem Abdul Jabbar and Ralph Sampson. In order to indicate to the Birmingham community that they were involved in the community, they contributed the land underneath to the Alabama Symphony Orchestra. They had asked which cultural organization needed a shot in the arm and we are to receive $50,000 a year in rent.

I am not sure that would have taken place if passive income was taxed.

In addition, we have just finished an endowment study that suggests that we can raise approximately $4 million in approximately 2 years, the income from that will provide a foundation of revenue. We would have to readdress our strategies if revenue from endowment was taxed.

Our expenses of approximately 65 percent represent payroll, either from salaries, employee benefits, and that is a significant payroll in the Birmingham area and would certainly have an impact on our economy if it was not there.

We have never received any problem or any criticism about competition from the for-profit industry. By the way, I used to be a banker and I understand the concerns that they have.

In fact, many of the for-profit organizations such as the beverage companies and radio stations are working with us in order to be able to provide an entree into the marketplace that they would not otherwise have.

I thank you for this opportunity to give these remarks.

Chairman PICKLE. And we thank you. I am sorry I was a little slow in recognizing you.

Have any of you had complaints from for-profit groups or from anyone with respect to unfair competition?

Mr. WOLFF. No, sir, not from Birmingham or the State of Alabama.

Mr. STEWART. No, no theater has.

Mr. PURRINGTON. Nor have we.

Chairman PICKLE. I want to get to this, do you actually file a form 990-T for the symphony?

Mr. WOLFF. No, sir. The same comment that was made before, we are focusing on our major goal and that is to provide education, to provide classical music or pops music to the public and promote the State of Alabama, and other than that we don't have any efforts.

Chairman PICKLE. Yes.

Mr. BLAIR. Mr. Chairman, as part of our survey we asked that question and we found that from the survey that 1.6 percent of the respondents or three groups paid a UBIT in fiscal year 1985 and that the total amount they paid was $5,458 on a total net income of $233,000. They were paid on activities that range from gift shop sales and art gallery rentals and sales.

Chairman PICKLE. Mr. Blair, I want to thank you for your testimony. You gave us some good details that we have not gotten previously. Thank you.

I also would like to have the results of the survey, the breakdown of it by category and by amounts. Would you just relate it to dollars for our subcommittee?

Mr. BLAIR. Yes, Mr. Chairman.

[The following was subsequently received:]

Jun [illegible]

REPORT ON
AMERICAN ARTS ALLIANCE
UBIT SURVEY

In anticipation of forthcoming congressional review, the American Arts Alliance, in January 1987, surveyed its membership on their income-producing activities; the extent to which the Unrelated Business Income Tax (UBIT) affects their institutions; and the degree to which these nonprofit arts institutions compete with commercial enterprises. The collected data, along with extensive testimony, will be presented to Members of Congress as they begin their review of the UBIT laws. This report highlights some of the survey's findings.

Income-Producing Activities

In September 1986, House Ways and Means Committee Chairman Dan Rostenkowski announced the Oversight Subcommittee's intention to review the different types of income-producing activities of nonprofit organizations. Accordingly, the American Arts Alliance questioned participants on, among other points, the different types of income-producing activities they engage in and the gross amount of income those activities generate.

The chart below lists the various income-producing activities, the percentage of survey respondents engaged in each activity, and the median amount of income those activities generate.

Income-Producing Activities

ACTIVITY	% OF RESPONDENTS ENGAGED IN ACTIVITY	MEDIAN INCOME
Gift Shop Sales	60.0	$30,000
Facilities Rental	46.0	$10,000
Program Advertising	43.4	$25,000
Catalog Sales	27.8	$20,000
Costume Rental	23.3	$ 2,926
Set Rental	22.8	$ 4,500
Equipment Rental	21.1	$ 1,350
Travel Services	18.3	$ 9,091
Mail List Sale/Rental	13.3	$ 900
Book publishing, and recording/ broadcast royalties	Less than 10	

43.3% of the survey respondents also reported income from "other" sources such as the rental of computer facilities, museum concerts and special film or lecture series.

As important as these activities are, the majority of survey respondents earned less than $75,000 from them, and 25% of all respondents earned less than $25,000.

Nonprofit arts organizations receive the bulk of their income from ticket sales. This income as a percentage of aggregate field income in the most recent fiscal year was 55% for dance, 49% for theater, 43% for opera and 41% for orchestra. As a percentage of total earned income, however, ticket sales are of great importance.

Unrelated Business Income

According to the Alliance survey, the number of nonprofit institutions reporting unrelated business income on their income-producing activities has steadily increased. 9.8% of the respondents reported unrelated business income in 1981; 12.0% in 1982; 13.1% in 1983; 14.8% in 1984; and 15.8% in 1985.

The survey revealed that in fiscal year 1985, 1.6% of survey respondents, or 3 groups paid $5,458 in UBIT on a total net income of $433,123. The activities for which UBIT was paid were gift shop sales and art gallery rental and sales.

Competition with Small Business

Statistics derived from the Alliance survey show the extent to which tax-exempt organizations engage in income-producing activities that could be carried on by small business. 97% of the respondents have never been accused of unfairly competing with small business. Further, 70% of the survey respondents said that no for-profit organization in their locality offers the same or similar services/goods.

Effectiveness of Current Legislation

The Alliance survey asked a number of questions concerning an organization's compliance with the law. In the past five years, only 2.7% (N=5) of the survey respondents have received rulings concerning their income-producing activities from the Internal Revenue Service (IRS); only one group reported that the ruling had a significant effect on their organization's income. Overall, 40% of the survey respondents have been audited by the IRS, but only 19% have been audited for unrelated business income.

Importance of Income-Producing Activities

Many organizations commented that their income-producing activities allow them to maintain valuable community service programs. For instance, the Trinity Repertory Company commented that the earned income from program advertising sales allows them to improve their publications and thus get more and better information to their patrons. The Minneapolis Institute of Arts said their museum shop "provides the museum visitor with the opportunity to purchase an object of artistic or educational interest and generally spreads the museum's educational and cultural message."

Many activities produce only enough income to cover the overhead expenses needed to provide a public service. For instance, the Milwaukee Repertory Theatre stated that "income from coat room sales merely defrays the cost of coat room attendants" and enables them to offer a valuable service to their audience.

Numerous groups voiced concern when asked what the effect would be of subjecting more income-producing activities to UBIT. The Lyric Opera of Kansas City reported that a more strict application of UBIT would curtail its "ability to produce quality opera" and meet their commitment to the community. The Evansville Philharmonic Orchestra said it "could mean the demise of the orchestra."

Conclusion

The statistics compiled in the Alliance survey demonstrate that in general nonprofit arts organizations' earned income is directly related to their tax-exempt purpose; the overwhelming majority of nonprofit arts groups are in full compliance with current UBIT laws and regulations; and that a stricter tax on the monies generated by income-producing activities would result in tremendous hardship for nonprofit arts organizations.

Chairman PICKLE. Do any of you have a comment about the Treasury recommendations? Have you seen them? Do you have any feeling on them?

Mr. WOLFF. The comment I would make is I think there is need for additional information as the Treasury says in order for us to understand the 990 or not-for-profit organizations so that where there is a problem they can be addressed.

Chairman PICKLE. All right.

We will keep that in mind.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

We are nearing the end of a long day so I will be brief. It was Mr. Stewart I believe, as you were running through the figures, Mr. Stewart, did you tell us that out of a total income of $7 million that you have $550,000 as salaries?

Mr. STEWART. No, the $550,000 figure was the budget for our Living Stage company which is our outreach company. That includes the salary of the actors involved in that company and the administration of that company.

Mr. SCHULZE. What percentage of the total $7 million is salaries?

Mr. STEWART. Well, I——

Mr. SCHULZE. I ask that because I presume the salaries are not comparable to other areas or maybe I am wrong. I thought maybe they were, the salaries would be relatively small. Is that correct?

Mr. STEWART. No, of the $7 million, up to $2 million of it is salaries and we have a very large organization. We have an employment of 175 individuals. We have an acting company of 18 actors who are on annual employment which that is unusual for our field. They receive a weekly salary of 52 weeks a year. That was made possible by a special grant from the National Endowment for the Arts.

Mr. SCHULZE. Thank you for that.

I have just one other question or statement that I want to make. Mr. Wolff, I am not knocking the contribution, I think it is marvelous but do you realize you can depreciate the building but you cannot depreciate the land?

Mr. WOLFF. That is correct.

Mr. SCHULZE. It is fine to be charitable but you can be tax-wise at the same time. I am glad they made it and I am glad that you get that kind of income. I think it is a marvelous endowment.

Chairman PICKLE. In that connection, I want to ask Mr. Wolff, how did you happen to get an endowment or contribution of lands presumably from Kareem and——

Mr. SCHULZE. And Ralph Sampson, yes. We found out afterwards that Kareem's father went to the Juliard School of Music and classical music had been part of his entire life.

Chairman PICKLE. Kareem's father had gone to the Julliard School of Music?

Mr. WOLFF. Yes, sir.

Chairman PICKLE. He makes great music.

Mr. WOLFF. You never know where it is going to come to help in the future.

Chairman PICKLE. Where did Ralph Sampson come into it?

Mr. WOLFF. I think he just came along.

Mr. SCHULZE. Mr. Chairman, I have no more questions.

Chairman PICKLE. Send him down to Austin, will you?

Mr. BLAIR. Mr. Chairman, you asked a question earlier about the proposed Treasury—the comments they had. I have looked at them briefly. I was unfortunately detained coming in from Ohio and in fact if it had not been for the ingenuity of one of your colleagues in chartering a plane, I would not have gotten here today. I would say on behalf of the Alliance we do share a substantial concern, particularly where the Treasury Department talks about reviewing the exemptions with respect to volunteers and the convenience aspect which are so important to us and also in the area of passive investment income.

I think previous panels and this panel have talked about the importance of passive investment income from endowments and other areas.

Chairman PICKLE. Would you be willing to give us a statement about your position with respect to the volunteer and what is the other aspect?

Mr. BLAIR. The volunteers, convenience aspect and passive investment.

Chairman PICKLE. If you would give us a further statement on that, please.

Mr. BLAIR. Yes, we will, Mr. Chairman.

[The following was subsequently received:]

AMERICAN ARTS ALLIANCE
1319 F Street NW Suite 307 Washington DC 20004 phone (202) 737-1727

AUG 05 1987

July 28, 1987

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

As Chairman of the American Arts Alliance, it is my pleasure to respond to your request for comments on the Treasury Department recommendations for potential change in the Unrelated Business Income Tax (UBIT) law. Those recommendations, presented at the recently concluded Oversight Subcommittee hearings on the UBIT and the income-producing activities of nonprofit organizations, raise a number of concerns for the nonprofit theater, opera, and dance companies, symphony orchestras, and art museums that make up the Alliance membership.

In its proposals, the Treasury Department urges the Oversight Subcommittee to retain the present-law test used to determine whether or not a trade or business regularly carried on by a nonprofit organization is exempt from tax. The Treasury Department states that the present standard, which is based on whether or not the business is substantially related to the exempt purpose of the organization, is valid and has "conceptual merit." The Alliance commends the Treasury Department's position on this point.

Additionally, Treasury officials call for detailed reporting on the business activities of nonprofit organizations, as well as stricter enforcement of the UBIT by the Internal Revenue Service. Treasury states that changes in these areas would help make the substantiality standard more administrable. We appreciate the Treasury Department's concern but hope that the subcommittee will keep in mind the tremendous burden that inordinate amounts of information-gathering and reporting pose to nonprofit arts institutions that in general have small administrative staffs. In developing new tax-reporting forms, we hope your subcommittee will work to insure that they are manageable to members of the nonprofit community.

The Treasury Department recommendations also call for a reexamination of the scope of the UBIT exemption for business activities operated by nonprofits for the convenience of officers, employees and others. Treasury states that the tax-exempt status of all activities should as a rule be judged on the basis of the activity's relatedness to the institution's main purpose, rather than the convenience such activity affords to institution personnel and/or members. Treasury argues that only when activities provide "significant administrable benefits" should they be considered defensible under the convenience standard.

We disagree with the Treasury Department on this matter. The present-law exemption is essential to the ability of arts institutions to provide important services to the public. It is on the basis of the current-law convenience standard that nonprofit arts groups provide food, coat room, parking, and other similar services that facilitate attendance by the public. For arts institutions, activities classified under the convenience argument are available not to the general public, but only that small portion of it attending a specific institution at a given time. In that sense, nonprofit arts institution use of the convenience standard has a very limited application. Additionally the "convenience" activities conducted by nonprofit arts institutions usually relate directly to the central institutional purpose -- that of making the artistic experience widely available to the public.

Also exempted from the UBIT under present law are the profits on business operated by volunteers. Here the Treasury Department questions "whether an unlimited exception for volunteer businesses is appropriate" and recommends reexamining the scope of exempted volunteer-run activities.

Should such a reexamination occur, we hope the subcommittee will keep in mind the following points. On economic grounds, it is inappropriate to tax an institution on the profits that result from unpaid labor. Conversely, if these organizations were to pay for the labor involved in these income-producing activities, it would significantly diminish any profits gained. Furthermore, taxing volunteer efforts would dampen the volunteer spirit. Volunteers are likely to be less willing to devote as much of their own time to the organization's fund-raising activities if they know that the ability of those activities to raise money for an institution is substantially diminished. It must be kept in mind that volunteers are vital to the arts community in helping to raise essential funds and heightening public awareness of the role the institution plays in the community at large. We discourage any action likely to result in a lessening of volunteer involvement.

With respect to computation of the Unrelated Business Income Tax, the Treasury Department recommends overturning the 1984 Second Circuit Court of Appeals Rensselaer decision that allows the expenses of operating an exempt facility to be allocated on a basis of total, actual use of personnel and facilities involved. In its place, the Treasury Department suggests allocating expenses based on the total amount of time the facility and personnel are available for use, rather than actually used. We believe that the Rensselaer case provides a fair and reasonable way of allocating expenses and disagree with the Treasury Department's proposal that it be reversed.

We do, however, support and commend the Treasury Department's recommendation to increase the prevailing deduction from unrelated business income from $1,000 to $5,000. We feel that this increase is in line with inflation and a positive change.

Similarly, we commend the Treasury Department's retention of the fragmentation rule.

Finally, we fully support the Treasury Department in suggesting that the exemption from the UBIT be continued for the passive income of public charities. As we stated in our testimony, endowments are a critical means by which institutions provide for their long-term stability. These funds, in helping to assure institutions an on going source of income, act as a buffer against fluctuations in yearly patterns of private giving and government support. Investment income is also important to 501(c)4 organizations. We believe this income should remain exempt from the UBIT when used to further the purposes for which the 501(c)4 institution was organized.

We hope that these views are helpful in your future deliberations on the issues raised by Treasury Department testimony. We will be happy to respond to additional questions and to continue working with you on these matters.

Sincerely,.

William P. Blair

William P. Blair
Chairman, American Arts Alliance

Chairman PICKLE. Well, we thank you. It has been a long day. You have been very patient and understanding.

Thank you for your cooperation. The committee will stand in recess until Monday morning at 9:30 in this same room, this coming Monday morning.

The committee stands adjourned.

[Whereupon, at 3 p.m., the subcommittee was adjourned, to reconvene at 9:30 a.m., Monday, June 29, 1987.]

UNRELATED BUSINESS INCOME TAX

MONDAY, JUNE 29, 1987

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

Chairman Pickle. The subcommittee will come to order. It is good to have a crowd here early on a Monday morning. This is the fourth day of hearings to discuss the administration and the effectiveness of the unrelated business income tax. To summarize, this is a tax imposed on the "commercial activities", I guess you could say, of tax exempt organizations. During our hearing today, we will receive testimony from those representing a wide variety of interests and concerns. We appreciate your testimony and ask you to summarize your statement within approximately 4 minutes time. We ask you also to please be specific in describing the effects the unrelated business income tax has on your operations and give us your views on the recommendations that have been given to us by the Treasury Department. If you do not find you have sufficient time within the 4-minute frame, we ask you to submit those views to us in writing.

Our panel today consists of the YMCA of the United States, Solon B. Cousins, executive director. Mr. Cousins, do you have also with you people who will be making statements?

Mr. Cousins. Yes, sir.

Chairman Pickle. Mr. James Ashley and Mr. Richard Betts, representing the YMCA. And then on the opposing corner, representing the International Racquet Sports Association, John McCarthy, executive director; Frank Eisenzimmer who is the president of the Cascade Athletic Club; and, Spencer Garrett, president of the Pierpoint Racquet Club of Ventura, Calif. Well, we are glad to have you gentlemen here and we would be pleased to hear from each of you but before we proceed, I want to ask my colleague, Mr. Schulze, if he has an opening statement.

Mr. Schulze. Thank you, Mr. Chairman. Mr. Chairman, I am pleased to join you in opening our second week of hearings on the unrelated business income tax exempt organizations.

Last week, we received testimony from the administration. We focused on two major problem areas, namely, research and the health care. In the research area, we heard claims that universities and other tax exempt institutes are using their preferential tax status to unfairly undercut for-profit laboratories for testing contracts. These activities do not depend upon any vague reference to what is a substantially related activity, but are based on an explicit statutory exemption in the UBI law. We should give a long and careful look at the Treasury Department's suggestion to narrow the research exemptions.

Next, we heard claims of unfair competition in the health care sector. Witnesses described the dual affect of price cutting and captive referrals in the hearing aid and durable medical equipment businesses. Even more significant, was the indication that some of this activity was not mere incidental byproduct, but was targeted at displacing existing small businesses. Some nonprofit hospitals may be hazardous to the health of small business.

Today we will round out some of the areas we addressed last week. We will hear more testimony about research activities and medical equipment. We will also consider recreational activities. Finally, we will hear witnesses discuss their concerns with several narrow provisions in the UBI law. Mr. Chairman, I join you in welcoming today's witnesses.

Chairman PICKLE. Thank you, Mr. Schulze. Any other member have any opening statements? If not, we will proceed now with the first panel. I think we will ask Mr. Cousins, the executive director of the YMCA of the United States, to start the testimony. I think we will have your statements and then we will open it up to questioning. So Mr. Cousins, if you will proceed.

STATEMENT OF SOLON B. COUSINS, NATIONAL EXECUTIVE DIRECTOR, YMCA OF THE USA

Mr. COUSINS. Thank you, Mr. Chairman. I am Solon Cousins, the director of the YMCA. I thank you and the committee for this opportunity to appear on behalf of 13 million Americans who participate in and support the YMCA. For over 100 years, we have had quality programs serving a broad range of community needs in communities all around the Nation, operated for the good of the community and, as a charity should, for the public interest. I would like to make four very specific points gleaned from our written testimony already submitted to the committee.

Chairman PICKLE. All right.

Mr. COUSINS. First, providing quality community fitness programs has been a priority for the YMCA since its beginning in the 1850s. Spirit, mind and body, the triangular holistic approach to personal development has been our theme all these years, with the physical side, the fitness side, and one piece of the triangle that we think is interrelated and integrated. From the gymnasiums, YMCAs have operated as far back as the 1850s, to swimming pools since 1885, this triangular view of health in spirit, mind and body has been a high priority for us and we continue to have it so. The IRS and taxing authorities in every State in the Nation have recognized this as an appropriate charitable purpose.

No. 2, the tax exemption of YMCA adult fitness programs reflects a strong public interest in the promotion of good health. As a nation, we are spending over $400 billion a year on health care. Medical experts agree that to control these costs, we must place must greater emphasis on preventive health care. Former Surgeon General Jesse Steinfeld commented some years ago that increased participation in fitness and health promotion programs such as those of the YMCA, and he mentioned us by name, must be a goal of our national health care strategy.

Third, the YMCA is different from commercial health clubs in four very specific respects which we think justify our continued tax exemption.

First, YMCA's belong to the community, not to private individuals. They are put there by the community, organized by the community, and supported by the community. Proceeds from programs of YMCA's go back into the program, as required by law. By contrast, dollars from the proceeds of health clubs go into the pockets of the owners.

Second, YMCA's serve all income levels in the community, regardless of profit. YMCAs rely on several sources of support—fees for service, donations from individuals, and the United Way, and volunteer time—to enable us to provide services to the whole community. We are serving the wealthy, the poor, and in every part of the city. In almost every Y, we are offering scholarships to those who cannot otherwise afford to belong to the YMCA. Sadly, health clubs are serving only those whom they can serve at a profit.

Third, YMCA's are dependable, long-term providers of quality fitness programs. We have been pioneers in providing quality community fitness programs for 100 years. YMCAs have highly trained staff and medically sound programs, and we work hard to promote a life-long commitment to health and healthy life-styles. Also, we have offered financial stability and continuity over all these years. We are here to stay. We always have been, and always will be.

Lamentably, the health club industry can make no such claim, particularly in the areas of financial stability and continuity of service. Twenty-seven States have laws regulating the operation of health clubs. Fifty-seven new bills have been offered just in the past year. No legislature, no State has ever enacted a law, as far as I know, that is specifically intended to protect the citizens from the YMCA.

Fourth, YMCA's provide many community services that commercial health clubs never will. Youth in government citizenship programs for teenagers; child care, both pre-school and after school; literacy programs for adults and children; parent/child programs and family activity of all kinds; camping; programs serving youth gangs on the streets of our cities; and seniors programs, like our new program in collaboration with the Arthritis Foundation for senior citizens who are suffering arthritis, a program we call Twinges in the Hinges. No health club is offering these programs.

Finally, let me point out that the IRS has closely scrutinized our fitness programs and has issued detailed guidelines to ensure that YMCA fitness programs serve the whole community. We feel that these tests are tough, but fair. While IRS audits numerous YMCAs every year, none has ever failed the test.

The Treasury Department has offered the subcommittee some recommendations for changes in the UBIT rules that we feel are promising and need further study and support. We do also strongly agree with Treasury that the relatedness standard is the proper standard and should be retained. YMCA's are working diligently to comply with the regulations. I have here in my hand a manual which the YMCA of the USA gives to every local YMCA showing how to comply, how to shape up, how to satisfy the tax laws of this country, and each YMCA complies to the best of its ability.

The national YMCA also provides a tax newsletter regularly to let local YMCAs know exactly what is in store for them should they be examined by the Government or by the IRS, under the unrelated business income tax regulations. We have been working diligently for years to comply as best we can with these rules. We are not without sin, with 2,000 operations around the Nation. But we do our best to meet the test that is put to us by the IRS each year. Mr. Chairman, we have never, never failed that test. Thank you.

[The statement of Solon B. Cousins and a letter subsequently received follow:]

Testimony of Solon B. Cousins
Executive Director, YMCA of the USA
June 29, 1987

Introduction

My name is Solon Cousins. I am Executive Director of the YMCA of the USA. I thank the Chairman and the Committee for the opportunity to appear today on behalf of the 13 million Americans who participate in and support the work of the YMCA.

Since its founding in 1851, the YMCA has been in the business of building character, promoting health, and changing lives. I am proud to say that the YMCA remains very much in that business today.

YMCAs have more than passing interest in the subject before the Committee today. As the Committee is well aware, commercial health club owners have recently devoted considerable effort to challenging the tax exemption of YMCA adult fitness programs. Other critics have attacked the tax exemption of YMCA child care and camping programs. These critics allege unfair competition, accuse the YMCA of breaking faith with our mission, and demand that the offending YMCA activities be taxed. I am confident that this Committee, and the Congress, when it fully understands the issue, will reject this demand and reaffirm the YMCA's tax exemption.

I am by no means an expert on the unrelated business income tax. Counsel tells me, however, that the tax incorporates a so-called "fragmentation rule," under which the IRS can isolate an activity like a YMCA adult fitness or child care program from the overall operations of the organization. I understand the rationale for this rule, and at one level approve of it. Tax-exempt organizations should not be allowed to shelter clearly unrelated commercial activities within a larger complex of exempt programs. However, at a deeper level, this fragmentation rule is a dangerous concept because it encourages the artificial dismemberment of organizations that are, in fact, organic wholes. Trying to assess the charitableness of a YMCA adult fitness or child care program apart from the rest of the YMCA is a little like studying a leg separated from the body. One might well conclude that the leg is unrelated to locomotion, but one's conclusion would be wrong. For this reason, it is important to talk briefly about the YMCA as a whole before focusing more specifically on those programs whose tax exemption has been challenged.

I. The YMCA, Past and Present

A. A Tradition of Service

The first YMCA in America was established in Boston in 1851. YMCAs quickly spread across the country. By 1862, there were nearly 200 local Associations. Today, there are over 900, operating over 2,000 YMCA facilities.

Throughout its history, the YMCA Movement's fundamental purpose has been to put Christian principles into practice through programs that build healthy bodies, minds, and spirits for all. The familiar triangle at the heart of the YMCA emblem has for almost a century symbolized the YMCA's commitment to building spirit, mind, and body. This commitment continues to define the YMCA's unique community service role today.

The YMCA has a proud history of innovative community service. The first YMCAs offered programs and services to meet the needs of young men flocking to the big industrial cities seeking employment and fortune. The YMCA became an alternative to the "wicked life on the streets." It was a place to find hometown newspapers, books, prayer meetings, Bible classes, evangelistic meetings, lectures, help in finding jobs, and decent boarding houses.

By the late 1850s, exercise and gymnastics began to appear for young businessmen who needed "relaxation, diversion, and animated recreations." Swimming pools were added by 1885. And by 1900, YMCAs furiously were building residences to keep up with the need for a wholesome, cheap place to stay.

During these early times, the YMCA gave the world new sports such as basketball and volleyball. It spawned such organizations as Boy Scouts, Camp Fire, and the USO. It served as the model for adult education, resident camping, college student services, and the beginnings of the junior college movement.

B. Meeting Today's Needs

While the YMCA's founding purpose and goals remain the same, today they are manifested in programs and services that span the spectrum of ages, sexes, races, creeds, abilities, and incomes. YMCAs have five community service priorities for the 1980s: promoting healthy life-styles, strengthening the modern family, developing leadership qualities in young people, increasing international understanding, and assisting in community development. These apparently diverse themes find unity in the fundamental philosophy of the YMCA movement: that persons must take responsibility for their own lives and actions and should join together to serve the needs of others.

Youth programs remain central to the YMCA's mission, serving over 6 million young people each year. YMCAs' work with youth has many facets:

- For tens of thousands of young people, the YMCA is the place to play basketball, swim, learn gymnastics, or join in other youth sports programs. Whatever the sport, the primary emphasis is on growing, not just winning. The cardinal rule -- that every child plays every game -- captures the spirit of a program built around the values of participation, fun, fitness, teamwork and fair play.
- YMCAs' popular Indian Guides program has for decades fostered companionship and understanding between parents and children.
- Youth camping is another strong YMCA tradition. 1985 marked the centennial of YMCA residence camping, and today YMCAs operate 289 resident camping facilities and thousands of day camps.
- YMCAs are also developing new youth programs to meet emerging needs. With the growth in two-income and single-parent families, providing quality, family-centered child care has become a priority for many YMCAs. Other YMCA programs deal with drug and alcohol abuse, youth unemployment, and teenage parents.

At the other end of the age spectrum, programs serving 500,000 senior citizens are an important and growing part of the YMCA's work.

- Through special swimming and exercise programs, YMCAs provide safe and healthful fitness activities for seniors.
- Rehabilitation programs like YMCArdiac Therapy and The YMCAs Way To a Healthy Back help senior citizens -- and many younger participants as well -- to overcome potentially debilitating illness and injury.
- Through pre-retirement seminars, clubs for retired men and women, day care for the dependent elderly, and a variety of other programs, YMCAs also help meet the social and emotional needs of older Americans.

Finally, YMCAs serve those who are neither young nor old -- 6 1/2 million Americans between the ages of 18 and 65 -- with a broad range of programs.

- YMCA adult fitness programs help millions of Americans adopt and maintain a healthy life-style.
- Programs like Home Team and Positive Parenting help parents to gain greater insight into family relationships and to strengthen those relationships by sharing quality time with their spouses and children.
- International education and exchange programs -- including direct linkages between individual American and foreign YMCAs -- bring an important international dimension to adult membership in many YMCAs.
- YMCAs offer a variety of educational, artistic, and cultural programs for adults.
- Community service is another important aspect of adult YMCA membership. YMCAs encourage adult members to volunteer their time to support youth and senior citizen programs and other YMCA activities. Working through its membership, one metropolitan YMCA has, for example, resettled over 3,000 Indo-Chinese refugees.

C. Strengths of the YMCA Movement

Few institutions can match the YMCA's record of sustained, effective public service. What have been the keys to the YMCA's success? Let me suggest four.

First, YMCAs have an enduring, ennobling, and flexible mission. YMCAs meet needs that all persons have in common. The YMCA mission encompasses the whole community, rich and poor, young and old, male and female. The universality of this mission has inspired generations of Americans to find in the YMCA an effective vehicle for their community service.

Second, YMCAs are responsive to community needs. Every local YMCA is autonomous and controlled by a local community board. This local control ensures that YMCAs stay in touch with their communities and responsive to changing community needs.

Third, YMCAs have mobilized broad-based community support. Because YMCAs serve the whole community, they draw support from the whole community. Last year, over 350,000 Americans served YMCAs as volunteers. Americans also gave their money to support YMCAs, a total of $173 million.

Fourth, YMCAs have had the benefit of sound, business-like management. The YMCA movement has a big heart, but a hard head. We know that good intentions alone never sent a kid to camp, funded a child care center, or rehabilitated a handicapped person. We know that charitable contributions alone cannot begin to support the scope of programming our communities want and need. Thus, as discussed more fully below, YMCAs have traditionally looked to those members and program participants of adequate means to support the work of the YMCA through membership dues and program fees.

These traits have sustained the YMCA as a vital community service organization for a century and a third, and they provide a solid foundation for our continued service.

D. Financing YMCA Services

In his September 12, 1986 press release, Chairman Rostenkowski posed several specific questions concerning the financing of tax-exempt organizations that I will now briefly address as they apply to YMCAs.

The major sources of YMCA income are summarized in the following table.

Table I

1986 YMCA Revenue By Source

		$	% of Total
1.	Total Program-related Income	780,125,352	74.6
	a. Membership Dues	311,047,736	29.7
	b. Program Fees	313,316,818	30.0
	c. Residence and other	155,606,798	14.9
4.	Charitable Contributions	173,907,090	16.6
5.	Government Grants	48,908,352	4.5
6.	Other	43,164,491	4.3
7.	TOTAL	1,046,105,285	100.0

As these data show, 74.6% of YMCA revenue comes from program-related income, primarily membership dues and program fees. Charitable contributions account for an additional 16.6% of YMCA income, with government grants and miscellaneous revenues comprising the remaining 8.8%.

As the data in Table II demonstrates, there have been no drastic fluctuations in either program-related income or charitable contributions over the period from 1950 to 1985.

Table II

YMCA Revenue Trends 1950-1985
(All entries are percentages of total revenue)

	1950	1955	1960	1965	1970	1975	1980	1985
1. Total program related income	72.8	67.9	66.9	68.0	72.6	74.4	70.4	72.9
a. Membership Dues	11.2	12.6	14.9	18.0	24.1	27.8	27.7	29.5
b. Program Fees	16.0	4.7	16.3	20.0	24.8	30.3	37.2	35.1
c. Residence and other	45.6	40.6	35.7	30.0	23.7	16.3	5.5	8.3
2. Contributions	20.3	22.3	22.7	22.0	20.1	17.5	18.8	18.3
3. Government Grants	*	*	*	*	*	*	8.5	4.8
4. Other	6.9	9.8	10.4	10.0	7.3	8.1	2.3	4.0

*Government grants included in line 4, "Other."

These data clearly refute the view of history often advanced by health club representatives in the competition debate -- that there was a golden age in which YMCAs were funded primarily by charitable contributions, and that current dependence on program-related income reflects a recent and dramatic fall from this state of grace. The "program-related income" line of Table II tells a very different story. Such income accounted for 72.8% of YMCA revenue in 1950 and 72.9% in 1985. Correspondingly, charitable contributions accounted for 20.3% in 1950 and 18.3% in 1985.

While the specific sources of YMCA program-related income have changed -- residence operations were the largest source in 1950, memberships, fitness programs, and child care predominate today -- all of the activities giving rise to this earned income have been and remain directly related to the YMCA's tax-exempt charitable purposes. While a handful of YMCAs operate small unrelated business activities taxable under current law, such activities have never been a significant source of YMCA income. With isolated exceptions, YMCAs do not conduct income-producing activities through for-profit subsidiaries, or participate in joint ventures or partnerships with commercial businesses.

II. YMCA Fitness Programs

A. YMCAs' Pioneering Role in Community Fitness

With this overview of the YMCA for perspective, let us now narrow our focus to YMCA fitness programs. YMCAs and fitness have been synonymous for decades. Indeed, YMCAs pioneered the development of community fitness programs and facilities more than a century ago. In 1860, a national YMCA convention unanimously endorsed the establishment of gymnasiums as "a safeguard against the allurements of objectionable places of resort." Though it may surprise our health club critics, who suggest that in the good old days YMCAs served only the poor, fitness for working people has always been a YMCA priority. In 1856, the Brooklyn YMCA's board of managers declared that business life overtaxed the muscular and nervous systems and was "deteriorating the physical and vital force of the present race of young men" who seriously needed "relaxation, diversion, and animated recreations." In 1910, Theodore Roosevelt traveled to Los Angeles to lay the cornerstone for the new downtown YMCA precisely because the facility incorporated a "businessmen's health club" to encourage fitness within the business community. Similar YMCA facilities have been providing fitness and other programs to the downtown business communities in most major American cities since the 1920s.

As this earlier generation of YMCA facilities wears out, we are committed to replacing them with modern facilities that will allow us to serve our communities well into the next century. Though our critics fault us for building quality facilities, we suspect few in the communities we serve would agree. The facilities are essential tools enabling YMCAs to continue our leadership role in providing affordable and effective community fitness programs.

Simply stated, our goal is to help Americans achieve lifelong health and fitness. We start early, and stick with it, offering swimming, exercise, and gymnastics programs for pre-schoolers, youth sports for school-aged youth, aerobics, strength training, swimming, and other programs for adults, and specialized programs for seniors, handicapped persons, and those in need of physical rehabilitation.

B. The Public Interest in Fitness and Health Promotion

YMCA adult fitness programs have always been exempt from federal, state, and local taxes because policy-makers recognized the public interest in encouraging community fitness programs. Today, that public interest is clearer than ever. Public health officials are unanimous on the need for greatly increased participation in fitness and other health promotion programs. The landmark 1979 Surgeon General's report, Healthy People, summarized the case for health promotion is these words:

> There are three overwhelming reasons why a new strong emphasis on prevention -- at all levels of government and by all our citizens -- is essential. First, prevention saves lives. Second, prevention improves the quality of life. Finally, it can save dollars in the long run. In an era of runaway health costs, preventive action for health is cost effective.

Several key facts underscore the urgency of this message. Health care costs annually consume over $400 billion, almost 11% of GNP -- up from 5% in 1960. Additional expenditures for high-tech medical procedures clearly offer diminishing returns. Over 50% of all death and disability is now attributable to heart disease and other life-style related illnesses that can be prevented far more cost-effectively than they can be treated. An aging population promises still greater burdens in the future.

Greatly increased emphasis on prevention programs -- including fitness programs like those of the YMCA -- offers the only realistic prospect for reversing these trends. As former Surgeon General Jesse L. Steinfeld has stated:

> Physical fitness and other health promotion programs like the National YMCA programs are now recognized by the medical community as an integral part of overall health care. The Surgeon General and other officials responsible for federal health care policy have clearly and emphatically stated that it is the policy of the federal government to encourage greatly increased participation in such programs. (Emphasis added.)

However, levels of participation in adult fitness programs remain far below those required to achieve significant public health benefits. In 1980, the Department of Health and Human Services advocated increasing the percentage of adults engaged in regular exercise from 35% to over 60% by 1990. However, a mid-decade assessment indicates that by 1985 participation levels may actually have fallen.

The exemption from federal, state, and local taxes currently enjoyed by YMCA fitness programs enables YMCAs to offer these programs at a lower cost than would otherwise be possible. This lower cost encourages increased participation, the stated goal of federal health policy. Taxing YMCA adult fitness programs would plainly frustrate that policy.

C. YMCAs and Commercial Health Clubs

By comparison to the YMCA, commercial health clubs are Johnny-come-lately's to the health and fitness field. Most have been established in the last ten to fifteen years, born of a fitness enthusiasm YMCAs worked for decades to create. Commercial health clubs have made no effort to match YMCAs' comprehensive community fitness programs for youth, adults, and seniors. Instead, they typically serve only those who can be served at a profit -- primarily young adults.

While they came late to the table, commercial health clubs now want the game to themselves. In the name of competitive equity, and in the interest of their bottom line, they ask this Committee to tax YMCA adult fitness programs. This position derives from pure self-interest. I am confident this Committee will agree that it is not in the public interest.

Commercial health clubs presumably share our view that federal policy should promote increased participation in adult fitness programs. Their quarrel is with tax exemption as the means of fostering that policy. Because tax exemption benefits only nonprofits like YMCAs, they regard it as unfair. To put their argument in simplest terms, they assert that YMCA adult fitness programs are just like their programs, and should be taxed like their programs.

This argument fails because its premise fails. YMCAs are not just like commercial health clubs -- never have been, never will be. Let me mention four obvious distinctions that clearly justify YMCAs' continued tax exemption.

First, YMCAs are nonprofit community service organizations operated solely for the benefit of their communities. No one owns a YMCA, except the community. No one profits from its operations, except the community. If a YMCA ends the year with an operating surplus, every dollar is plowed back into the community to expand YMCA programs. Commercial health clubs always have the option of converting to nonprofit status and seeking the same tax exemption as a YMCA. The fact that not one commercial club has exercised this option strongly suggests that these clubs are, indeed, run for very different purposes than a YMCA.

Second, whereas commercial health clubs serve only those they can serve at a profit, YMCAs provide fitness programs for the whole community. Commercial health clubs concentrate on middle- and upper-income adults. YMCAs serve all ages, from pre-schoolers to seniors, and all income levels. YMCAs also offer both members and nonmembers a wide range of specific fitness programs -- for example, aerobics, stress management, and weight reduction -- at fees generally in the range of $25 to $40.

Further, virtually all YMCAs offer financial assistance to persons unable to pay. Examine the program brochure of a typical YMCA, and you will find a statement to the effect that "Financial aid is available," or "No one will be turned away because of inability to pay." Some YMCAs have established sliding fee scales, others determine appropriate financial assistance arrangements on an individual basis. Whatever the form, these policies reflect YMCAs' commitment to community service and affordability.

Community affordability is also a requirement for tax exemption. Under existing unrelated business income tax rules, YMCA adult fitness programs are taxed unless the YMCA can demonstrate that the programs serve a broad segment of the community. (See IRS Tech. Ad Memo. 8502002, 8/5/84) YMCAs audited by the IRS must document, through appropriate demographic data, that their adult fitness programs are serving a broad segment of the community. No YMCA has ever failed this community affordability test.

The single-facility focus of both our health club critics and the IRS fails to capture a further dimension of YMCAs' commitment to community accessibility. While our most visible facility in larger cities may be our downtown center, we have other facilities and program sites throughout the community. In New York City the YMCA has 21 branches, in Philadelphia 22, in Chicago 29, in Houston 22, in Los Angeles 25. Many of these serve low-income areas where you won't find commercial health clubs. For example, the Philadelphia YMCA has invested $7 million in inner-city facilities in the last five years. The Los Angeles YMCA recently opened a $5.5 million program center in the heart of Watts and plans another $2.5 million facility in a poor Hispanic community in East Los Angeles. The Chicago YMCA invested $8 million in its New City YMCA serving the low-income Cabrini Green community, and is building a $9 million facility in the impoverished southside community of Woodlawn. The Washington, D.C. YMCA's board has just approved a capital campaign for a new $5 to 6 million center serving inner-city youth. The list could go on, but the point is clear. Unlike commercial health clubs, YMCAs are committed to serving the whole community.

Third, YMCAs are reliable, long-term providers of quality community fitness programs. YMCAs pioneered community fitness at a time when no one dreamed of making a profit on it. Commercial health clubs proliferated only when the profit potential became clear. I draw this contrast not to say simply that we were here first, but rather to highlight our very different motives. YMCAs are committed to fitness because of our mission; commercial health clubs because of profits. This difference in motives translates into very clear differences in operations. YMCAs have devoted great effort over many years to developing a broad array of medically-sound health and fitness programs. We have a rigorous system of staff training and certification to ensure that our programs are safe and effective. We emphasize health education, and the importance of a life-long commitment to a healthy life-style. We care about each person we serve. We have a solid record of financial stability and continuity of service.

In short, YMCAs have demonstrated that they are a reliable, effective instrument for advancing the public interest in providing quality community fitness programs. In the words of a former President of the American College of Sports Medicine: "YMCAs are unquestionably the leading provider of medically sound physical fitness programs in the United States today."

Commercial health clubs can make no such claim. While there are many reputable clubs, the industry as a whole has a well-documented history of "fitness" fads, consumer fraud, high pressure sales tactics, and bankruptcy. For example, in 1984, the Florida Department of Agriculture and Consumer Services received 2,436 consumer complaints against commercial health clubs, 16.5% of all complaints. The story of a commercial health club closing its doors without refund or compensation to its "lifetime" members is hardly news. Clubs commonly sell long-term memberships in a volume that far exceeds the capacity of their facilities, relying on the established fact that most persons will use the club regularly only for the first month. Plainly, such clubs do not and cannot encourage members to continue an effective long-term fitness program -- their commercial viability depends on precisely the opposite behavior. Moreover, if and when profits diminish, commercial clubs will exit as quickly as they entered, leaving YMCAs to meet communities' needs for fitness programs.

Finally, YMCAs earn their tax exemptions by serving their communities in a host of ways commercial health clubs never will. I have already described the diversity of YMCA community service programs -- after-school child care, youth sports, Youth in Government, youth employment, seniors programs, international exchanges, parent-child and family activities -- I won't repeat the whole list. Many of these programs, including virtually all YMCA youth programs, are heavily subsidized with donated funds, volunteer labor, and, in many cases, with surplus funds from adult fitness programs.

Each of these three sources of subsidy depends heavily on YMCAs' adult fitness programs. Where the adult program generates a cash surplus, this connection is obvious. For example, the Memphis YMCA has earmarked the expected surplus from its newly renovated downtown center to provide a continuing operating surplus for a nearby branch serving the black community. The downtown Washington YMCA budgets $1 million in support each year for community service programs other than adult fitness.

The connection between adult fitness programs and YMCAs' ability to obtain charitable contributions and volunteer labor, while less obvious, may be even more important. Adult fitness programs draw into the YMCA thousands of persons who go on to become volunteer leaders and financial contributors. For an organization that depends on over 350,000 volunteers and over $170 million in annual charitable contributions, the importance of this progression from participant to volunteer leader and contributor can hardly be overstated. If the YMCA served only the poor, as our health club critics suggest we should, this community support would be far more difficult to develop.

III. Comments on the Unrelated Business Income Tax

The Committee's September 1986 press release invited comments on the adequacy of the unrelated business income tax (UBIT) rules and of their enforcement by the IRS. In our view, the unrelated business income tax establishes an appropriate framework for regulating charities' income-producing activities. The law in this area must balance two conflicting social goals: the need to encourage charitable activity on the one hand, and the need to prevent unfair competition by tax-exempt organizations on the other. The relatedness standard strikes a very practical, commonsense balance. Commercial activities a charity engages in primarily for profit are taxed even though that profit funds other admittedly charitable programs. Activities that directly advance charitable purposes are not taxed, even though they may compete with some commercial businesses.

We cannot agree with those small business advocates who fail to see the need for balance, who argue that competition considerations are of overriding importance, and who would, therefore, replace the relatedness standard with a rule that charities be taxed on any activity that competes with commercial business. This view ignores the hard fact that charities cannot operate without fee-for-service income; it also fails to give appropriate weight to society's interest in encouraging charitable activity.

The relatedness standard is also frequently criticized as being vague and uncertain. In a sense it is, for the same reason that the underlying concept of a charitable purpose is uncertain. The courts and the IRS have long recognized that the concept of a charitable purpose is continually evolving to reflect the changing needs, values, and knowledge of society. As one classic formulation puts it:

> The enforcement of charitable uses cannot be limited to any narrow and stated formula. It must expand with the advancement of civilization and the increasing needs of man. New discoveries of science, new fields and opportunities for human action, the different condition, character, and wants of communities change and enlarge the scope of charity. Todd v. Citizens Gas Company of Indiana, 46 F.2d 855, 865 (7th Cir. 1931, Cert. den., 283 U.S. 852.

This fluid concept presumably has always been an aggravation to those administering charitable tax exemptions. But from the broader societal point of view, this flexibility has appropriately been regarded as a virtue, not a vice. It has ensured that charities remain flexible and creative instruments for responding to society's needs.

For YMCAs, IRS enforcement of the UBIT has been vigorous and persistent. Numerous YMCAs are audited each year. Over the last 15 years, the IRS has closely scrutinized the UBIT status of 2 major YMCA activities -- residences and adult fitness programs. In both cases, the IRS National Office, after intensive analysis, established specific criteria to determine relatedness. For residences, these criteria focus on the extent to which the facility is serving the young, the poor, military personnel, and other charitable classes. (Rev. Rul. 76-33, 1976-1 C.B. 169) For adult fitness centers, as discussed above, the key standard is community affordability. The IRS National Office has used revenue rulings, technical advice memoranda, and internal training materials to communicate these criteria to IRS field agents, who have consistently, and in many cases, quite vigorously, applied them to local YMCAs.

On its own initiative, the YMCA of the USA has also worked to ensure compliance with these standards by local YMCAs. We have prepared and distributed to all YMCAs a 135-page YMCA Tax Exemption Manual. We also distribute a 4-page YMCA Tax Newsletter each month. The emphasis in both publications is on compliance, not tax avoidance.

IV. The Legal Concept of Charity

Most fundamentally, the debate between YMCAs and commercial health clubs comes down to a question about the role of nonprofit charities in our society. The health clubs and their allies argue that the legal concept of charity should be limited to providing free or subsidized services to the poor or disadvantaged. On this view, any charity significantly dependant on fee-for-service income would be taxed.

Whatever else can be said for or against this narrow view of charity, one thing is clear: it is a radical departure from the legal concept of charity consistently applied by courts and affirmed by legislatures for centuries. I attach to my testimony a legal memorandum which discusses this matter in detail. As this memorandum makes clear, the law has consistently defined charity in terms of benefit to the community at large, not just service to the poor. Thus, Harvard University, Lincoln Center, and the Mayo Clinic are all tax-exempt charities, not because they are primarily engaged in serving the poor, but because they benefit the community.

The law is equally well settled that charities may charge fees for their services -- even fees that cover all costs of the service and produce a surplus to support other activities of the charity -- provided that the services advance charitable purposes and that the fees are affordable by a significant segment of the community. The legal definition of charity does not require that services be offered free or substantially below cost.

Consistent with these principles, the courts have long recognized that the promotion of health is a charitable purpose. Moreover, it qualifies as a charitable purpose without regard to whether full cost fees are charged, since, like education, it furthers the public good regardless of subsidy. The tax exemption of YMCA adult fitness programs rests ultimately on these solid, well-settled legal foundations.

The broad and flexible "community benefit" concept of charity has served America well for centuries. It has fostered an array of voluntary organizations astounding in their diversity and in the richness of their contributions to the public good. Those proposing to tamper with this well-proven legal standard should bear a heavy burden of proof. None of the arguments advanced in the current competition debate even remotely begins to meet this burden.

Conclusion

Let me bring this discussion to a very practical close. If YMCA adult fitness programs were taxed, whose interests would be served?

Commercial health clubs? They would say yes, but I think they are wrong. If YMCAs were taxed, we would be under great pressure to increase earned income to pay the additional cost. These financial pressures might well force YMCAs to compete far more directly and aggressively with commercial clubs.

Nor would the federal Treasury significantly benefit. After offsetting operating costs, depreciation, and other allowable deductions, few YMCA adult fitness programs would have any taxable income. That is not to say, however, that a decision to impose UBIT on adult fitness programs would have no financial implications for YMCAs. On the contrary, state and local tax assessors would almost certainly take such a decision as a signal to impose property tax on YMCA facilities, thus adding a substantial burden to YMCAs' already strained finances.

Finally, and most importantly, taxing YMCAs would not be in the interests of the communities we serve. Every dollar a YMCA must pay in tax is a dollar less to support worthwhile community service programs. If YMCAs were taxed, the cost of services to members and participants would increase, perhaps prohibitively, the accessibility of services to all segments of the community would be reduced, and expansion into neighborhoods most in need of human services and community development would seriously be curtailed.

In short, preserving YMCAs' tax exemption is in the public interest.

YMCA of the USA
Washington Office
[illegible] 15th Street NW
Suite [illegible]
Washington, DC [illegible]

[illegible]

June 30, 1987

The Honorable J. J. Pickle
U. S. House of Representative
Washington, D.C. 20515

Dear Chairman Pickle:

In his testimony before the Oversight Subcommittee on June 29th, commercial health club representative Spencer Garrett made an incendiary reference to "yatching classes" allegedly offered by the Beverly Hills California YMCA, an allegation subsequently repeated in the Washington Post. The allegation was a complete fabrication. The Beverly Hills YMCA does not offer yatching or sailing classes of any kind. Nor, to the best of our knowledge, do any other YMCAs in California.

Here are the real facts about the Beverly Hills YMCA:

* Built in 1945, the YMCA is a modest facility with a pool, gym, exercise equipment, activity rooms, and a leaky roof.

* One block inside Beverly Hills, on the middle-income southside of that community, it draws the majority of its members from adjoining middle-income areas of Los Angeles.

* Its extensive youth programs include a major after-school and summer child care program created in response to community appeals for help in meeting the child care needs of the growing number of single-parent families. Out of a total child care budget of $260,000, $60,000 is used for scholarships for low-income children.

* "Street people" shower at the YMCA, at no charge, on a daily basis.

* Almost 20% of the YMCA's members are over age 55. Many participate in special programs for victims of Parkinson's disease, arthritis, and back problems. The YMCA receives public funding to help pay for the participation of low-income senior citizens in these programs.

In short, the Beverly Hills YMCA is a typical nonprofit community service organization -- not the up-scale commercial operation suggested by the health club representatives' false and misleading statements.

[illegible]

[illegible]
Executive Director

This is not an isolated lack of candor by commercial health club representatives. Attached is a letter sent by John McCarthy, Executive Director of the International Raquet Sports Association (IRSA), to IRSA's board and strategic planning committee in December 1984. In his letter, clearly not intended for public consumption, Mr. McCarthy presents his views on commercial health club charges against YMCAs -- views absolutely contrary to those he presented yesterday to the Oversight Subcommittee. He states that "the *fact base* of the club contentions about the Y's was erroneous," and that "allegations that Y's are no longer serving their social mission are not based on an investigation of the facts." Despite this finding, Mr. McCarthy and IRSA have pursued their attack on the YMCA in the interest of their own bottom line.

Mr. Chairman, we sincerely request your help in setting the record straight. We ask that this letter be included in the record of the hearing at the point where Mr. Garrett's statement appears, and that the Subcommittee recall Mr. Garrett and ask him to account for his misleading statement.

YMCAs are proud of our solid record of community service and we welcome the Subcommittee's scrutiny. We have already provided the Subcommittee with extensive data on our operations, and stand ready to provide whatever additional data you desire. I am sure you share our desire that the Subcommittee's decision be based on a full and accurate understanding of the facts.

Sincerely,

Solon B Cousins

Solon B. Cousins
Executive Director
YMCA of the USA

Attachment

IRSA
International Racquet Sports Association
112 Cypress Street
Brookline, Massachusetts 02146
617 / 734-8000

Dear Board and Strategic Planning Committee:

I have completed an investigatory trip to three markets in which the issue of unfair competition between YMCA's and clubs has generated considerable heat.

In each of these markets (Washington, D.C., Rochester, N.Y., and Portland, OR), I found similarities that I list as follows:

1. In none of the markets was the leadership of the club community communicating with the leadership of the Y community.

   In each case, there was public and private bickering, but no effort to address issues on a person-to-person basis.

   Further, in each market, I had no difficulty in reaching the topmost levels of Y staff and Board leadership.

   In short, Step I toward resolving differences had not taken place in any of these markets.

2. Because of this failure to communicate, the fact base of club contentions about the Y's was erroneous.

   To mention several illustrative examples:

   a) It had been alleged that the Portland YMCA's were only serving the wealthy.

      The Portland YMCA was able to show me two public documents which read "None Shall be denied participation in any Y programs by reason of financial difficulty."

   b) It had been alleged that the Rochester YMCA did not serve children.

      In my three hour visit, I saw at least 30 children involved in Y programs.

   c) It had been alleged that the Downtown Washington Y no longer served the poor.

      The day before I arrived, the Y had presented a check for $10,000 to the Ethopian Relief Fund. A weekly Food Bank for the aged poor operates out of the Y.

From my experiences in Portland, Washington, and Rochester, as well as Denver, Chicago, Boston and New York City, I have come to the conclusion that allegations that the Y's are no longer serving their social mission are not based on investigation of the facts.

3. It is alleged that the Y's are suddenly entering the adult fitness market.

   The fact is that the Y's have been pursuing adult fitness since the beginning of the twentieth century. President Theordore Roosevelt worked out at the Washington, DC YMCA. Colonel Naismith invented basketball in the Springfield Y. Joe Sobek invented racquetball in the Greenwich Y. Volleyball originated in the Y. The Y/American Red Cross swim program has been the country's swim program for 40 years.

In short, wherever I have gone, I have found much discussion based on untested facts and assumptions.

Regards,

JMC(ph)

John McCarthy
Executive Director

JMC/ph

Chairman PICKLE. Thank you, Mr. Cousins. I will ask Mr. Ashley, immediate past chairman of the National Board of YMCA, to proceed. Mr. Ashley?

STATEMENT OF JAMES W. ASHLEY, IMMEDIATE PAST CHAIRMAN, NATIONAL BOARD OF YMCA OF THE USA

Mr. ASHLEY. Thank you, Mr. Chairman and thank you and the committee for inviting me here this morning. I am the immediate past chairman of the YMCA of the USA. I am also the past chairman of the Chicago Y, which serves some 500,000 people in the Chicago metropolitan area. My remarks will be directed as to how YMCA's and their programs are financed, and the YMCA's relationship to the unrelated business income tax. Total 1986 YMCA income in the United States was $1.06 billion: 74.6 percent of that figure was from membership dues and program fees, 16.6 percent of that money came from charitable contributions, including the United Way support, 4.7 percent of that money came from governmental grants, both State, Federal and local, and the remaining 4.1 percent came from investment income, sales of goods, and other sources described in my written statement.

YMCAs use this $1.06 billion to fund the broad range of programs that Mr. Cousins has described. A more detailed list of YMCA programs is attached to my written statement. Most of these YMCA programs have been in existence for many, many years. They cover the entire spectrum of our civilization. They do things for all kinds of people in all kinds of situations. They are clearly an expression of the YMCA's charitable purpose.

Interestingly enough, it has been suggested by some that the YMCA has changed its direction, its method of financing, its operations. The suggestion is that while it used to finance itself with charitable contributions and target its services on poor people, it is now financing itself with health club activities and businessmen centers and the like. The facts tell a very different story.

In 1950, 72.8 percent of the income of the YMCA was program-related, fee income: membership dues, fees, camping charges, and so forth. In 1985, 35 years later, 72.9 percent of the YMCA revenues came from the same places and for the same types of programs. So you see that we are financing ourselves in 1986 and 1987 and 1985, just as we did in 1950. Equally in the contribution side of the equation, in 1950, 20.3 percent of the income of YMCA's generally came from charitable contributions. In 1985, that figure was 18.3 percent. Again, the relationships remain constant. The YMCA's ability to finance itself and where to finance itself from has not changed.

Now, Mr. Cousins mentioned the fact that we have been challenged by the IRS on an on-going basis and we have been successful. I know that one of the purposes of this committee is to look into the whole area of unrelated business income and I will be very candid and tell you that there have been YMCA's from time to time that have paid taxes on unrelated business income. And if a YMCA has unrelated business income, it reports it and files a 990-T and pays whatever may be due. Most of those instances are minuscule, in terms of the entire operation. They relate to things like a YMCA acquiring real estate for expansion, having borrowed the money, and then using that real estate until the expansion has been completed, for a parking lot or some other facility for which they receive income. It is the kind of activity that is prudent, it is perfectly appropriate, and in those situations, the tax gets paid and the matter is handled in a totally proper fashion.

I think I can say, sir, that the YMCA conducts its financial affairs in line with its charitable purposes and the requirements of the Internal Revenue Code. It does it properly and it does it in a fashion that furthers those charitable purposes for the betterment of some 13 million people in the United States who use those services. Again, thank you very much for including me in the group this morning.

[The statement of James W. Ashley follows:]

Testimony of James W. Ashley
Immediate Past Chairman, National Council of YMCAs
June 29, 1987

INTRODUCTION

My name is James W. Ashley. I am immediate past Chairman of the National Board of Young Men's Christian Associations. I am one of over 360,000 Americans who each year contribute millions of hours of volunteer community service through their local YMCAs. In my case, I have served as a YMCA volunteer at the local, regional, and national level for over 20 years. I have gladly given this service because I have seen the difference the YMCA makes in the lives of millions of Americans.

In his September 12, 1986 press release, Chairman Rostenkowski raised a number of specific questions concerning the manner in which tax-exempt organizations finance their operations, how their revenue sources have changed over time, and the extent to which they engage in unrelated business activities. My testimony responds to these questions as they apply to YMCAs. It is based on data collected annually by the YMCA of the USA from the more than 900 independent local YMCAs.

YMCA REVENUE IN 1986

1986 revenue of YMCAs is summarized in Table I.

TABLE I

1986 YMCA REVENUE BY SOURCE

	$	% of Total
1. Total Program-related Income	780,125,352	74.6
a. Membership dues	311,047,736	29.7
b. Program fees	313,316,818	30.0
c. Residence	64,733,026	6.2
d. Camp Revenue	63,153,060	6.0
e. Sales Revenue	17,580,280	1.7
f. Food service	10,294,432	1.0
2. Charitable Contributions	173,907,090	16.6
3. Government Grants	48,908,352	4.7
4. Investment Revenue	23,299,483	2.5
5. Other	19,865,008	1.6
6. Total	1,046,105,285	100.0

Membership dues and program fees. As Table I indicates, program-related income -- primarily membership dues and program fees -- accounted for 74.6% of total YMCA income in 1986. Membership dues from local YMCAs' more than 5.5 million youth and adult members accounted for 29.7% of total revenue. Program fees paid by both member and nonmember program participants accounted for an additional 30% of total revenue. All of the programs for which these fees are charged are directly related to YMCAs' charitable mission of putting Christian principles into practice through programs that build healthy bodies, minds, and spirits. These YMCA programs include fitness classes, youth sports, day camps, swimming instruction, pre-school and after-school child care, parent/child programs, rehabilitation programs, fitness testing, job training, Youth in Government, drug abuse prevention, and counselling. (For a more complete list of programs provided by local YMCAs, indicating the number of YMCAs offering each program, see Attachment #1.) Program participants who can afford to pay are charged a modest fee to help cover program cost. Persons unable to pay the established program fees are typically allowed to participate free or at a significantly reduced cost.

Camp and Residence Income. In 1986, revenue from YMCA resident camp and day camp operations accounted for 6.0 percent of total YMCA revenue. Income from residence operations -- the low-cost, dormitory-style accommodations YMCAs have provided in many communities for decades -- accounted for 6.2 percent of total revenue.

Sales and Food Service Income. The remaining 2.7 percent of program-related income was attributable to sales revenue (1.7%) and food service (1.0%). Sales revenue consists of income from the sale of publications and other program materials, as well as sales to members and program participants of racquet balls, swimming goggles, and similar athletic equipment directly related to YMCA fitness programs. The food service income is attributable to the snack bars and lunch rooms operated by some local YMCAs for the convenience of their members.

Charitable Contributions and Other Income. In 1986 charitable contributions accounted for 16.6 percent of total YMCA revenue. The remaining 8.7 percent of total revenue was comprised of government grants (4.7%), investment revenue (2.5%), and miscellaneous revenue (2.0%).

TRENDS IN YMCA REVENUE

Table II summarizes trends in the major sources of YMCA revenue over the period from 1950 to 1985.

Table II

YMCA Revenue Trends 1950-1985
(All entries are percentages of total revenue)

	1950	1955	1960	1965	1970	1975	1980	1985
1. Total program related income	72.8	67.9	66.9	68.0	72.6	74.4	70.4	72.9
a. Membership Dues	11.2	12.6	14.9	18.0	24.1	27.8	27.7	29.5
b. Program Fees	16.0	4.7	16.3	20.0	24.8	30.3	37.2	35.1
c. Residence and other	45.6	40.6	35.7	30.0	23.7	16.3	5.5	8.3
2. Contributions	20.3	22.3	22.7	22.0	20.1	17.5	18.8	18.3
3. Government Grants	*	*	*	*	*	*	8.5	4.8
4. Other	6.9	9.8	10.4	10.0	7.3	8.1	2.3	4.0

*Government grants included in line 4, "Other."

As the data in Table II demonstrates, YMCAs' relative dependence on program-related income and charitable contributions has remained virtually constant from 1950 to 1985. Program-related income accounted for 72.8 percent of YMCA revenue in 1950 and 72.9 percent in 1985. Charitable contributions accounted for 20.3 percent in 1950 and 18.3 percent in 1985.

While total program-related income has remained relatively constant as a percentage of total YMCA revenue, the relative importance of particular types of program revenue has changed significantly. For example, as Table II indicates, residence operations accounted for a far larger portion of total YMCA revenue in 1950 than they do today. Correspondingly, membership dues and program fees have more than doubled as a percentage of total revenue over this period.

It is critical to recognize, however, that all of the significant sources of YMCA earned income -- membership dues, program fees, camp and residence income, and sales revenue -- are directly related to YMCAs' tax-exempt charitable purposes. When local YMCAs file their Form 990s with the IRS, they quite properly report this income as non-taxable "related" income.

The relatively small amount of revenue YMCAs derive from food service operations is also generally exempt from unrelated business income tax because the operations are carried on primarily for the convenience of YMCA members, rather than for the public generally.

UNRELATED BUSINESS ACTIVITIES

Relatively few YMCAs engage in unrelated business activities for which they must file a Form 990-T, and even for these YMCAs, unrelated business income accounts for an insignificant amount of total revenue. Because so few YMCAs engage in unrelated business activities, the YMCA of the USA has never solicited information about such activities in its annual survey of local YMCAs. However, a recent survey of 20 YMCAs revealed that only one had ever engaged in any unrelated business activity. In this one case, the YMCA had operated a parking lot on debt-financed property, which the YMCA sold ten years ago. The experience of the YMCA of the USA legal staff, which routinely advises local YMCAs on tax matters, suggests that the results of this survey are typical of YMCAs nationwide.

Table II provides a further indication of the insignificance of unrelated business income for YMCAs. Any unrelated business income received by local YMCAs would be reported in the "Other" category or the "Investment Revenue" category on Table II. These categories together comprise only 4.0 percent of total revenue. Moreover, the bulk of the revenue reported in even these two quite small revenue categories plainly is not unrelated business income. "Investment Revenue" consists overwhelmingly of passive investment income from YMCA endowments, which is explicitly exempt from unrelated business income tax. Likewise, the "Other" income category includes revenue from annual fundraising events, sales of capital assets, and various other types of income not subject to unrelated business income tax.

For the relatively small number of YMCAs that do have unrelated business income, the most common source of this unrelated income appears to be debt-financed real estate. For example, a YMCA may rent an unused portion of an old YMCA facility, or rent other property which has been donated to the YMCA. In either case, if the rented property is subject to a mortgage or other indebtedness, a portion of the rental income must generally be reported as taxable unrelated business income. Another example of the sort of unrelated business activity engaged in by some YMCAs would be a commercial parking lot owned and operated by the YMCA on land adjacent to its facility. Taxable unrelated business income from all sources comprises a de minimis amount of total YMCA revenue, and there is no indication that the amount of such unrelated income is increasing.

SUBSIDIARIES, PARTNERSHIPS, AND JOINT VENTURES

With isolated exceptions, YMCAs do not conduct income-producing activities through for-profit subsidiaries, or participate in joint ventures or partnerships with commercial businesses.

ATTACHMENT #1

Table 21. Programs Provided by YMCAs

	% of YMCAs with program	Number of YMCAs with program
Fitness Classes	82.2	1375
Aquatic Progressive Skills	76.0	1273
Youth Sports	75.7	1268
Volunteer Training	71.0	1192
Day Camp	70.8	1185
Skills Training	65.7	1101
Infant-Parent Aquatics	64.8	1081
Aquatic Exercise	62.0	1041
Adult Leagues	59.8	1001
Leadership Training	57.0	955
Informal Education	56.6	947
Aquatic Safety	54.0	905
Senior Programs	53.1	889
School Age Child Care	49.3	825
Recreation	47.7	798
Aquatic Team Sports	46.0	766
Parent Child Groups	45.9	768
Preschool	41.9	702
Aquatic Specialty	40.0	664
Social Development	37.3	624
Health Enhancement	34.2	562
Community Development	32.2	542
Counseling	29.3	490
Family Groups	28.6	478
Corporate Fitness	26.8	454
Program for Disabled	26.4	444
Rehabilitation Programs	26.3	442
Health and Fitness Testing	25.5	426
Job Training	24.9	417
Cultural and Performing Arts	24.7	414
International Relationship Support	24.2	405
Summer Resident Camp	20.0	335
International Education	19.2	332
Basic Need	16.7	279
Travel and Caravan Camping	14.7	246
Religious Study	14.3	240
Formal Education	12.3	206
Employment Services	11.9	200
Resident Camp—Fall, Winter or Spring	10.7	179
Family Communication Skills	9.7	163

Chairman PICKLE. Well, we thank you, Mr. Ashley. And now, for the YMCA again, Richard Betts, president of the YMCA of Philadelphia. Mr. Betts.

STATEMENT OF RICHARD BETTS, PRESIDENT, YOUNG MEN'S CHRISTIAN ASSOCIATION OF PHILADELPHIA AND VICINITY, ON BEHALF OF THE YMCA OF THE USA

Mr. BETTS. Thank you very much, Mr. Chairman. The health effort of the YMCA stands on its own. Solon Cousins has already discussed the strong public interest in encouraging health and fitness programs like those of the YMCA. That fact alone justifies the tax exemption of these programs. I want to focus my comments on how adult fitness programs strengthen YMCA's ability to provide a broad range of additional community services. The difference between a YMCA and a health club is that a YMCA is driven by the desire to respond to needs, not necessarily just markets. There are tremendous disadvantaged communities in Philadelphia. They have had a severe reduction over recent years in government funding. Many organizations have folded their tents and left those economically stressed communities. During that period of years, the Philadelphia YMCA has invested $7 million in the building of new inner city YMCA's and the upgrading of other ones. That is 62 percent of the total capital money it has spent; $6 million out of $16 million operating dollars is spent by this association every year in target poverty communities.

Philadelphia has tremendous educational needs. Mayor Goode has indicated that nearly 40 percent of Philadelphians read beneath the fourth grade level. There are few public funds going into that need. The Y, 2 years ago, undertook the development of a chapter II literacy program, which is now the largest independent provider of literacy services in the State of Pennsylvania, with 115 operative sites. No person has ever been charged a penny for that service; 2,500 people have learned to read, 476 have been placed in jobs, 322 have been upgraded in their employment, and it has meant tremendous savings to the Government. And the reason it can be done is because of the pool of volunteers drawn to the Y in the adult fitness area, those volunteers being trained to teach reading.

Sixty percent of the children in the Philadelphia elementary schools flunked the State tests. The Y has created, in urban communities, child readiness centers that are enriched programs, to ready those children to succeed in school. In the last half of their third year, they are able to read at the first grade level. They are computer literate at 4 years of age and they enter school believing in themselves and being able to meet high expectations. We have now extended that system all the way to high school graduation and are testing methodologies for urban education, all of that heavily subsidized through the Y system.

The family in this society and in Philadelphia, is going through revolutionary change. Most of the development of children must now occur outside the home. We are faced with the fact that the largest influx of people into the employment pool today are mothers of children from zero to six years of age; 80 percent of women between the ages of 25 and 54 will be employed by 1992. We have developed, over recent years, quality child care to meet the needs of families with preschool children. After school, we have got worse problems. In the State of New Jersey in 1985, one out of every four fires was started by a child at home alone after school. We have created 18 centers to provide services for children for whom no one is at home after school, and these children participate, whether they can afford to pay or not.

We have also created summer care programs because so many children have no one home in the summer when elementary school is out. We now have 29 centers. We will touch the lives of 9,000 children this year; 86.4 percent of those who have registered for the summer care programs this summer are children for whom no one is at home during the day. We are starting a pilot program in seniors day care and we want to expand that program because the need is great. But we are not sure we will be able to, given the taxation situation, because the earned income of the YMCA through adult fitness provides the fixed costs of running all of our facilities and making them available to all of these other programs.

The youth in Philadelphia have some real problems; 60 percent of the homes in the urban community are single-parent homes; 30 percent of the homes across America are single-parent homes; 90 percent of those homes are without a father. The Philadelphia Y has created the YMCA Buddy System to reach to children of single-parent homes. It is operating at 17 of our YMCAs and no child ever pays a penny for that program.

Teen drug abuse in the Philadelphia area, and your areas, is a critical problem; 283 juvenile courts surveyed last year indicated that 90 percent of the cases that come before them are the product of alcohol or drug abuse on the part of teenagers. To deal with this problem, the Philadelphia Y created the We Can Say No Program. In the month of May alone, the program reached 5,400 kids who came to seminars to learn about the difficulties of drugs. And over 1,000 parents came to seminars at night to learn how to deal with the drug problem. The program will be expanded to four communities in 1988, but we will not be able to expand it to the 13 additional communities where it needs to go in 1989, if we do not have the benefit of the revenues from our adult fitness services.

In 1986, Y's provided services in Philadelphia to 376 other community organizations who meet and plan and provide services in YMCA's because they do not have facilities. Because the fixed costs of our facilities are covered by our adult fitness activities, every one of these organizations receives the use of our facilities at a discounted rate or at no cost at all. We are a staging area for other community services.

A response to need is what drives the YMCA. Our programs are in and of themselves a response to an important community need and also strengthen the Y's ability to respond to other needs. The health and fitness programs help fund the fixed costs of building space for all of these other kinds of programs I have described. In Philadelphia, in 1986, the YMCA received $2,250,000 of volunteer service. And a great deal of that came from adults who came to those fitness programs and were recruited out of that pool to work with children, work with youth, teach people to read. The fitness programs are also an important source for recruiting volunteers and financial supporters. You are being asked to create a level playing field. But if we are to lose all of these services in order to meet the demands of commercial health club owners, then I am afraid that 5 and 10 and 15 years down the road, you will have created an empty playing field in many communities.

Let me suggest that the scenario is something of this kind. You are being asked to walk into a dining room where 1,000 people are sitting and eating. Some are poor, some are rich, all are receiving nutrition eating at that table. There is someone who comes in to you and says, look, we need to pull the rug from under that table to make things right. And they are telling you that if you do it just right, if you snap it in just the right way, you can pull that rug without any of the dishes falling over, the china being broken, the people losing the food that is on the table. And I urge you, when you are asked to do that, to say no.

[The statement of Richard Betts follows:]

Testimony of Richard Betts
President of the YMCAs of Metropolitan Philadelphia
June 29, 1987

Introduction

My name is Richard Betts. I am President of the Young Men's Christian Association of Philadelphia and Vicinity. I thank the Committee for the opportunity to testify today.

In testimony presented by YMCA of the USA Executive Director Solon Cousins, the Committee has already received a detailed explanation of how YMCA adult fitness programs promote the good health of the communities they serve, and thus directly advance the YMCA's charitable mission. This point is critical to the issue at hand, and is itself sufficient to justify the continued tax exemption of YMCA adult fitness program. I will not discuss this point further only because Mr. Cousins has dealt with it so well. Instead, my testimony will focus on the extent to which financial resources and volunteer labor drawn into the YMCA through its adult fitness programs enable the YMCA to provide a broad range of critically important community service programs.

The Philadelphia YMCA operates 22 branches and 180 satellite program centers touching the lives of nearly 300,000 persons yearly within Philadelphia and its Pennsylvania suburbs. Its stated Mission for the 80's is "to enable persons more fully to realize their God-given promise in mind, spirit, and body." It has sought earnestly to carry out that mission as have other YMCA's across America. The denial of tax exemption would dramatically undercut its ability to continue to do so.

I. Key Service Initiatives Over the Past Five Year Period

In the past five years, the Philadelphia YMCA has:

A. Spent $7 million in construction and restoration of YMCAs in target poverty areas;

B. Implemented a 115 site adult literacy and job placement service for persons reading below the fifth grade level at no cost to any participant (the largest non-public program of its kind in the state of Pennsylvania).

C. Provided facilities and programs of preventive health activity not only for adults, but for massive numbers of children, youth, senior citizens and the handicapped, these latter constituencies virtually all being subsidized by the YMCA;

D. Acted as a community development catalyst in 22 areas of Metropolitan Philadelphia by opening its buildings on a subsidized basis to hundreds of community organizations to meet, work and plan within;

E. Created the Y Buddy System, a Metropolitan-wide program (no cost to any participant) training and matching able and caring adults with children of single parent homes who desperately need such special friendship if they are to grow up as contributors to the society;

F. Developed a demonstration system of five inner city schools carrying limited income children from 24 months of age to high school graduation on an innovative educational and human development track enabling the full realization of the student's potential.

It produces a considerable shock to our system when we hear it announced that the YMCA is not charitable. Only those who do not know fully what we are doing could in good faith make such an accusation. The balance of my testimony presents a more complete description of the foregoing community service programs and the manner in which they are supported by the YMCA's adult fitness program.

Tax Exemption is Critical to the Provision of YMCA Community Services

A. Construction of Inner-City YMCA's

The commitment of the Y to communities of economic deprivation is deep and lasting. The Philadelphia YMCA built a new $2.5 million branch in inner-city north Philadelphia in 1981. It built a $3.2 million new YMCA in inner-city west Philadelphia in 1983. It upgraded its major YMCA in inner-city south Philadelphia at a cost of $400,000 in 1984. It re-opened and restored the YMCA of Chester, Pennsylvania, an intensely needy community south of Philadelphia, whose Y had gone bankrupt and had been sustaining losses of over $150,000 per year; Philadelphia YMCA costs in capital repair and early operating losses at Chester exceed $600,000. Upgrading of other inner city Y's plus development of a Y youth guidance center facility in urban Norristown drive investment in poverty areas over $7 million in the five year period 1982-86. The operation of the massive inner-city plant referred to above would be made impossible if its adult fitness income were taxed. The participation of employed adults in these YMCAs provides stability and strength that is critical to their ability to sustain in subsidized social service programs for those in need. Surplus funds from suburban YMCA units also aid in the financing of these urban operations. It is noteworthy that no health clubs have proposed to build or provide service in any of the communities in which we have invested so heavily.

B. Literacy Training -- Adult Basic Education -- Jobs

In its long range planning process, Philadelphia YMCA leaders identified adult illiteracy as a key problem receiving minimal public funding. Statistics suggest that over one-third of the city's citizens are reading at or under the fourth grade level. Correlation of low reading ability with unemployment and family disorganization is extremely high.

In 1985 the Y began implementation of its Chapter II Adult Literacy Training program. That program is now operating at 22 YMCA's and 93 additional sites across the area with key focus being in disadvantaged communities. Y literacy experts trained over 1000 volunteer literacy coaches in 1986. To date the program has taught nearly 2,500 functionally illiterate adults to read, has placed 476 in jobs, and has enabled another 322 to achieve upgraded employment. No learner has ever been charged a cent for this program. Recently the Y has added three adult basic education training centers in inner city branches; these carry learners who have reached the fifth grade level onward to the ninth grade level at which point G.E.D. training is available. Each of these units includes a computer-assisted learning center to prepare students for an information-intense society. There is no charge.

This program is built substantially on volunteers recruited out of the adult health and fitness constituency of our various YMCA's. They constitute, when trained for service, an enormously powerful teaching force for adult non-readers. They aid in finding employment for their students. They assist Y instructors in acquainting the student with user-friendly computers. They save the American taxpayer hundreds of thousands of dollars every year.

C. Preventive Health Services for the Full Spectrum of People Within Communities

The Philadelphia Y has for several generations provided preventive health activities for the full spectrum of ages and peoples within communities. From the year 1884, it has offered such programs for working adults. From inception of this emphasis, program-related income from serving employed adults has enabled the YMCA to provide at subsidized rates health and recreation for children, youth, seniors and the handicapped. Traditionally, due to the limitations in the donated pool of resources, the adult health and fitness activities have provided the lion's share of the fixed costs of operating YMCA facilities. Because of this, Y's have been able to serve other constituencies without assessing a full allocated cost of facility use. The Philadelphia Y discounts its membership rate for senior citizens at every branch. In virtually all of its Y's, the children and youth membership rates are provided at less than true cost.

Morever, funding of the fixed costs of building operation through the adult fitness services enables the Y branch to provide space for much-needed social service programs at less than full allocated cost to the program or participant. For example, none of our Ys charges a cent to the Chapter II Literacy programs which demand thousands of hours of training and tutoring space in YMCA buildings.

It is to us something of a mystery that a health club which assiduously avoids promoting use by youth, handicapped, and senior citizens can detect no difference between itself and a YMCA that consistently strains to bring them in.

D. Community Development Catalyst

The YMCA within its community is a place of trust and confidence for all citizens. Consequently, it is sought after and used by scores of community organizations as a place of meeting, planning and work. In Philadelphia, the Y's are a hub of community involvement and collaboration. The coverage of a major share of the cost of building operation by adult health fitness resources makes it possible for the Y to open itself to use by community organizations at less than full allocated cost. In many cases, this is critical to their ability to operate effectively.

An example of the Y as community catalyst can be seen in the Association's key role in the development of a consortium of agencies in one community to work aggressively to impact issues of teen drug abuse. This effort will be enlarged in 1988 to the Y's development of similar consortia in thirteen additional communities. Needless to say, no meeting or program growing out of this teen drug abuse initiative in any community will ever be charged for use of YMCA space.

The taxing of Y adult fitness activities which fund so much of the fixed costs of YMCA facility operations, will impact upon countless other community service organizations which have come to depend upon use of Y space at less than its real cost. The loss will utterly beggar the gain.

E. New Help to the Children and Parents of Single Parent Homes

Over half of the children in minority communities in Philadelphia are growing up in single parent homes. Well over one in five homes in the Metropolitan area has but one parent. In 90 percent of cases, it is the male role model who is absent. Existing Big Brother/Sister programs reached but one percent of single parent homes. The YMCA inaugurated in 1986 the "Y Buddy System" to match children of single parent homes with a caring adult special friend to help fill the void of the missing parent. The program is now operative at 15 of our YMCA Branches. No child or adult is ever charged.

The key to the Buddy System is the Y's thousands of adult members who are used as the pool from which to recruit adult Y Buddies. Program brochures announcing health and fitness programs are heavily laced with invitations to volunteer for the Buddy System. The adult fitness constituency becomes the core group for this major new service to the single parent home.

In addition, Y adult and child "Buddies" have free use of Y facilities at all times when they are together. Y multi-purpose space is used for "Single Parent Seminars" focused upon aiding the lone parent in coping effectively with parenthood as well as life itself.

Taxation would weaken severely the ability of adult fitness activities to cover fixed costs of space for the Buddy System; it would also reduce the size of the volunteer pool on which the program is based.

F. Demonstration Schools for the Education of Urban Children

Beginning in 1982, the YMCA sought to develop a model system encompassing pre-school readiness, elementary school, and junior/senior high schools to demonstrate the capabilities of limited income children when placed in a stimulating environment of high expectations. The objective is the development of new, effective methodologies for urban education. The system is focused upon children of limited income and requires the involvement of the parent/s in the child's learning experience. It has been cited in numerous national magazines as one of the most exciting Black educational programs in the nation. The program is subsidized at the pre-school and elementary school level and approximately one-half of junior and senior high students are on some kind of scholarship. Over a thousand children are involved. The academic leader has served as Commissioner of Basic Education for the state of Pennsylvania.

Each of the five YMCA Academies is located in a major YMCA Branch. The schools utilize pools, gyms, activity rooms, locker rooms, and outdoor facilities of these Y's without cost. The operative costs of these facilities have already been largely met by revenues from the adult fitness activities carried on within the Y Branch.

Y's are an organic whole. The right hand assists the left in carrying out a significant human service mission. You cannot damage the right hand without severely reducing the work of the left.

III. On Replacing A Rock With Slipping Sand

If magnificent institutions of service are to have their plug pulled to meet the demands of for profit "Johnny come lately's," the full gamut of needs within communities across America will go increasingly unmet in the years to come.

The reality is that there is no service the Philadelphia Y can provide that is not susceptible to attack by an entrepreneur who enters the field late, creams off the high paying segment of the constituency, and then declares that the Y is competing with him unfairly by being in the field at all.

What is being proposed by this tax challenge will eventuate not in a level playing field, but an empty playing field. Having undercut the capability of historic service organizations to work effectively in communities, the for-profit enterprises will serve in only a few of the areas of need previously met by the versatile nonprofit.

The government will become increasingly familiar with this spectrum of unmet needs, because it will be pressed to address them. The level playing field will ultimately militate toward one on which government is the only player for a dramatically growing constellation of human needs. It could have been otherwise.

Statement of Sam Evans
Chairman, National Board of YMCAs
June 29, 1987

My name is Sam Evans. I live in Salina, Kansas, and am Chairman of the National Board of the Young Men's Christian Associations.

Mr. Chairman, I thank you and the Committee for the opportunity to testify today. In his testimony, YMCA of the USA Executive Director Solon Cousins has already discussed in some detail the work of the YMCA, our adult fitness programs, and the current challenge to their tax exemption. I would like to add to his comments the perspective of a long-time YMCA volunteer.

The issue before the Committee today is far more than a tax issue, it is about the heart and soul of our communities. In Salina, where I live, there are 40,000 people; 10,000 of them are YMCA members. For hundreds of cities and towns like Salina across the nation, the YMCA is a major center of community life.

I have been on the Board of the Salina Family YMCA since 1969. I joined because it was clear to me that the YMCA is one of the most important forces for good shaping youth in Salina. Five thousand young people participate every year in our youth sports, aquatics, camping, and other youth programs. A youth membership costs $25 a year, participation in any one of our youth sports leagues costs another $5. Any youth who cannot pay gets a full scholarship through our Back-a-Youth Program. In all of our youth programs, the emphasis is on character development and Christian values.

The Salina YMCA also provides much needed programs for adults and families. They come to the YMCA for our exercise programs, our "healthy back" course, and our special "Aquacise" program for seniors and handicapped persons, and a variety of other programs. They use the YMCA's facilities for their own individual fitness and recreation programs, supported by the expertise and encouragement of YMCA staff. A single adult membership costs $150 a year, a family membership costs $252. If an adult or family cannot pay, we make special accommodations.

Having served on the Salina YMCA Board since 1969, I have seen what it takes to make all of this happen. It is not easy. It takes the support of the whole community: over 300 volunteer coaches and referees for the youth sports programs; $2.1 million in capital contributions to fund a much needed new facility; and over $220,000 in annual contributions to subsidize programs, particularly youth programs, that will never pay their own way.

Salina provides this extraordinary support because the YMCA is providing extraordinary service.

The same is true in communities all across America. I first joined the YMCA National Board in 1974, and, in my service as a National Board member, I have had occasion to visit many YMCAs. They differ greatly, because the communities they serve differ. But there is a common denominator: everywhere the YMCA is an organization through which persons from all segments of the community can join together in the public interest, an organization with a commitment to Christian values, an organization responsive to community needs because it is community-controlled, and an organization that is making a difference in the lives of its members.

Confronted with the example of the Salina YMCA, or any one of hundreds of similar YMCAs, our commercial health club critics will probably say that these are not the kind of YMCAs they want to challenge. But the arguments they advance are not so discriminating. They argue that the YMCA and other tax-exempt nonprofits should concentrate on serving youth and the poor with free or heavily subsidized services. In their view, providing fitness programs -- or, by implication child care, family counselling, or other traditional nonprofit human services -- to adults who can afford to pay is not an appropriate charitable activity and should be taxed.

Let us be clear: this is not a prescription for taxing a few YMCAs on a portion of their revenue. It is a standard that would tax virtually every YMCA, as well as many other nonprofit organizations which are significantly dependant on fee-for-service income.

For YMCAs and other nonprofits in Kansas, this is not just an abstract concern. On May 4, 1987, the Kansas Board of Tax Appeals, with some encouragement from small business interests, voted to return all of the property of the Topeka YMCA to the tax rolls. This ruling was not triggered by any change in the Topeka YMCA's operations, which are quite similar to those of the Salina YMCA. Instead, the Board's decision derives from a narrow interpretation of the concept of charity. Whereas the law has traditionally defined charity in terms of service to the community as a whole, the Board ruled that an activity is charitable only if it involves providing free or subsidized services to persons unable to pay. The fact that 23 percent of the persons participating in the Topeka YMCA's programs receive full or partial scholarship was not sufficient, in the Board's view, to qualify the YMCA as a tax-exempt charity.

YMCAs face active challenges to their tax exemption in two other states, Oregon and Illinois. In both cases, the challenge derives from the same narrow, "almshouse" concept of charity applied in the Topeka case. None of these cases has yet reached even the first level of judicial review. I would hope that the courts in each of these states will recognize the dangers inherent in the tax collectors' narrow view and will adher to the traditional legal concept of charity as service to the community. This Committee can significantly encourage that result by reaffirming this broader view of charity as a matter of federal law.

What is at stake here is nothing less than the tradition of volunteerism that observers since de Tocqueville have regarded as so uniquely American. It is no exageration to say that voluntary community service organizations like YMCAs are precious national resources. They routinely accomplish a sort of social alchemy that greatly enriches our social order. Taking ordinary people and modest resources, they produce creative solutions to community problems that neither government nor business can address so effectively. They motivate millions of Americans to give selflessly of their time and their money to improve the quality of life in their communities. The YMCA alone inspires over 360,000 Americans annually to contribute millions of hours of volunteer service. An even greater number of Americans support the YMCA with contributions, a total of more than $170 million in 1986.

Richard Cornuelle, a long-time observer of voluntary organizations, has captured the point well. He writes:

> Perhaps most important of all, the voluntary sector has provided the principal channel through which any citizen, regardless of age, race, affluence, or ability, can act on his concerns, rallying support in whatever way he chooses, within the limits of society's basic sanctions.
>
> Thus the voluntary sector uses human qualities that commerce and government, necessary as they are, cannot so readily use. It is the channel through which the citizen can become more fully involved.
>
> Without the voluntary sector's complex enabling machinery, the human qualities most essential to building a good society -- caring, resourcefulness, creativity -- would have no ready outlets. So the third sector is not just a social convenience, it is an essential, integral, and indispensable part of American society.

Because the voluntary sector is so much a part of our social fabric, we are in danger of taking it for granted. We Americans are inclined to forget, as Cornuelle observes, that "the idea of private organizations working in the public interest, so familar to us, is practically unknown elsewhere."

We must conserve this unique and valuable social resource with the same persistence, care, and commitment with which we preserve our natural resources. I fear, however, that our recent record in this regard is not a good one. We seem to be expecting the voluntary sector -- particularly human service organizations like YMCAs -- to do far more with less. Since 1981 federal government funding for social services has been cut by over $100 billion. There has been a universal appeal to voluntary organizations to "take up the slack." Yet recent changes in the tax law significantly reduce incentives for charitable giving. Now, tax accessors and small business interests challenge the right of voluntary organizations to rely on fee-for-service income. One wonders how voluntary organizations are to fund their programs. Even the alchemist does not make gold from nothing.

More fundamentally, one fears that the narrow concept of charity our critics propose would break the bond, the identity, between charities and their communities. Communities across America support their YMCAs because in a very real sense the YMCA is the community. Narrow the YMCA's role to serving only a part of that community and you risk severing the very relationships that keep the YMCA alive and working for all.

The lone dissenter from the Kansas Board of Tax Appeal's decision in the Topeka YMCA case summed up the situation in the practical way we like to approach our problems in Kansas.

> This Board must interpret [the requirements for charitable tax exemption] so as to avoid an unreasonable result. Here we have a well established non-profit institution functioning in the private sector with the cooperation of the citizenry and performing a function, the absence of which undoubtedly would be filled by local units of government. To impair this working situation hardly seems reasonable and there is certainly no guarantee that placing these functions directly under the public sector would increase the efficiency or promote economy. I believe that the majority might well be making a poor trade to substitute direct taxation for indirect tax relief in the present case.

I urge this Committee, likewise, to recognize the important contribution voluntary organizations like YMCAs are making to this country and to reject any change in the tax laws that would threaten their important work.

Chairman PICKLE. Thank you, Mr. Betts. Now we will go to the other panelists. I believe the first one will be Mr. McCarthy, John McCarthy, executive director of the International Racquet Sports Association. Mr. McCarthy.

STATEMENT OF JOHN McCARTHY, EXECUTIVE DIRECTOR, INTERNATIONAL RACQUET SPORTS ASSOCIATION

Mr. McCARTHY. Good morning. Congressmen, distinguished colleagues from the YMCA. As the executive director of IRSA, a trade association composed of 1,100 taxpaying athletic fitness and racquet centers, I, along with my colleagues, Mr. Frank Eisenzimmer of the Cascade Athletic Club, in Gresham, Oreg., and Spencer Garrett, the Pierpoint Racquet Club in Ventura, Calif., come here today seeking only one thing. That one thing can be stated in a single phrase—genuine accountability. We are not opposed to the YMCA. We ask only that each individual Y facility be treated exactly as each of us already is, namely, that each Y facility be required to show cause, on an annual basis, as to why it should or should not receive tax exemption. The YMCA is the largest player in the fitness industry. There 2,000 centers gross more than $1 billion a year. A new Y opens its door in this country every nine business days. At this moment, there are more than 150 new YMCA's on the drawing boards and it is not fair for our Government to subsidize, directly and indirectly, one part of an industry and not to subsidize the other part, unless that subsidy is truly warranted on the basis of a case-by-case review.

The YMCA is one of the most decentralized public institutions in America. Except for a few broad guidelines established by its national headquarters in Chicago, the policy and practice of each of this country's 2,000 Y facilities is determined entirely by its local board of directors and its local executive staff. Because each Y determines its own course, it is essential that each individual facility be evaluated annually as to whether or not it is an authentic public charity. The simplest proof of the necessity to do this is the fact that in the last 18 months, local tax authorities in five different jurisdictions in four different States, have either already revoked or are in the process of revoking, YMCA tax exempt status. In Topeka, Kans.; in Portland, Oreg.; in Pittsburgh, Pa.; and in Rock Island and Moline, Illinois local tax officials have determined that the YMCA's in their communities can no longer be classified as public charities according to the laws of their States.

We are here today to contest the Y at five different points. First, the Y wants to say that the operation of a fitness center is, in itself, a charitable activity. We are here to tell you that the IRS has never agreed to that. Second, the Y wants to say that each and every YMCA is, in itself, a community benefit. We argue that every neighborhood shoe store or dry cleaner or pharmacy or bookstore has, on the face of it, just as much a claim to be providing a community benefit as any Y, and all of them pay their fair share of taxes. Third, the Y wants to say that the UBIT, as it currently stands, is a sufficient safeguard against YMCA commercialization. We say that when an organization defines its purpose as the physical, spiritual, mental, and moral improvement of its members, nothing on God's earth is unrelated to a purpose so broadly defined and that therefore, the relatedness test is totally useless.

Fourth, they want to suggest that fitness centers often produce a surplus that can be used to subsidize genuinely charitable work. We respond that the IRS no longer recognizes the destination of income as a title to tax exemption. Finally, they want to tell you about all the good work they do. We respond that McDonald's, Disney, Ford, Chrysler, and GM all do an awesome amount of good work but good works themselves do not give title to tax exemption. What can we tell you about the YMCA?

We can tell you that 94 percent of our clubs are in direct competition for members with tax-exempt YMCA's. We can tell you that 63 percent of these YMCA's are targeting the same socioeconomic clientele as are our taxpaying clubs. We can tell you that payroll costs at the average YMCA run 56 percent of total revenues as opposed to 29.8 percent at taxpaying fitness centers. We can tell you that from a consumer's perspective, nothing different happens at a YMCA fitness center than happens at a taxpaying club. And you can prove that to yourselves right here in Washington if you will join the National Center YMCA at the charitable price of $67 a month.

We will not bore you with the litany of direct and indirect advantages that accrue to all YMCA's by reason of their automatic tax exempt status. But we will say this: approximately 80 percent of the new Y's being built in this country are being constructed in either affluent suburbs or in downtown business and professional districts. We take a single example. Does it make sense for our Government to subsidize, through tax exemption, the yachting classes at the Beverly Hills YMCA.

We close by stating that there are two readily available, historically validated tests, of a bona fide public charity. The first is who is being served. If YMCA's do not have as their primary service focus, members of the so-called charitable classes; namely, the poor, youth, the handicapped, the elderly, minorities, et cetera, they are nothing but discount health centers, the discount being made possible by the direct and indirect subsidies that come through tax exemption. As recently as 1973, the IRS was revoking tax status, wide tax status, on the grounds of whether or not their services were primarily focused on helping members of charitable classes. Second, a charity is only a charity where there is some true giving; namely, when the service that is being offered efficiently is being offered at or below its actual costs. If a YMCA can show that its cost to providing service efficiently, exceeds the price charged for those services, then there is true giving and there is an authentic charity. Thank you.

[The statement of John McCarthy and attachments follow:]

STATEMENT OF THE INTERNATIONAL RACQUET SPORTS ASSOCIATION

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the International Racquet Sports Association ("IRSA" or "the Association"). My name is John McCarthy. I am executive director of the Association. IRSA is the national trade association for the tax-paying racquet, athletic, and fitness club industry. The association has a membership of over 1,100.

During the past few years, IRSA members have faced increasing competition from and lost business to tax-exempt Young Men's Christian Association ("YMCA" or "Y") fitness facilities that serve not only members of "charitable classes", but also wealthy professionals and executives. As a tax-exempt organization, the YMCA enjoys tax and other advantages unavailable to tax-paying fitness centers. IRSA submits that when Congressional policy confers special tax or other advantages on a taxpaying fitness center's competitors, that fitness center cannot compete as effectively. This advantage constitutes unfair competition.

I. Commercialization of YMCA Facilities

As an initial matter, IRSA would like to explain to the Subcommittee how the YMCA's fitness facilities have recently undergone radical changes in basic purpose and operating structure. The YMCA is no longer a neighborhood fitness facility serving the young, poor and disadvantaged. The new Y competes in the same market as do IRSA's members. For the past five years the health club industry has witnessed the progressive commercialization of Y facilities as they have sought to position themselves at the center of the upscale fitness market, in both affluent suburbs and the downtown business and professional centers. The National Center YMCA in Washington, D.C. epitomizes the new Y. The press, including Newsweek, the New York Times, the Los Angeles Times and Wall Street Journal have noted this phenomenon. Currently there are approximately 2,200 YMCAs in the United States. Collectively, they gross close to 1 billion dollars. A new YMCA opens every nine business days and over 150 new YMCAs are now on the drawing board.

The new Y health facilities resemble commercial fitness centers in virtually every respect: pricing structure, advertising policies, and investment record. A recent IRSA survey of market rate Y membership prices shows that YMCAs charge from 30 to 50 dollars a month and attract the same socio-economic market segment as comparable commercial clubs. Y advertisements are no different, in content and format, from those of commercial clubs. Finally, across the country, YMCAs have abandoned facilities built to serve the homeless and disadvantaged and opened new facilities to provide for the athletic and fitness needs of professional men and women. It is clear that YMCAs are engaged in business activities identical to those carried on by IRSA's members. In fact, from the consumer's perspective, there is no discernable difference in membership in a Y and membership in a private health club. Too often, an existing YMCA serves as a barrier to tax-paying fitness centers that wish to enter a market area.

II. Income Tax Treatment of YMCA Fitness Facilities

The YMCA enjoys exemption from federal income taxation as a public charity exempt under section 501(c)(3) of the Internal Revenue Code. The original recognition of the Y's exempt status centered on its religious and charitable functions. The YMCA's original charter, as amended, describes its purpose as follows:

> To promote the Christian way of living among its members and constituents, to promote the physical, mental, social and spiritual welfare of persons and to emphasize reverance for God, responsibility for the common good, respect for personality, and the application of the Golden Rule in human relationships.

However, today's YMCA activities extend far beyond its traditional role of ministering to the physical and spiritual needs of the poor and disadvantaged. IRSA submits that current law, as interpreted by the IRS, is inadequate to resolve either the proper tax treatment of income derived from Y health club activities or the tax exempt status of YMCA fitness facilities with the primary purpose of serving groups of individuals not properly characterized as "charitable classes" under the traditional law of charity.

For purposes of the Subcommittee's inquiry, the first issue that must be addressed is whether, in fact, the income derived from the Y's fitness centers constitutes unrelated business income. As an initial matter, it should be noted that the provisions governing the treatment of income of tax exempt organizations have changed over the years. In 1924, the Supreme Court decided that for purposes of tax exemption, the source of income of a non-profit organization was not the key issue; what was important was the destination of the income. Trinidad v. Sagrada Order de Predicadores, 263 U.S. 578 (1924). This provision allowed tax-exempt organizations to generate income from any source, including the acquisition of profit-making businesses, if the net profits were devoted to activities that were recognized as exempt.

The destination of income test was abandoned in 1950, when Congress adopted the unrelated business income tax. A three part test was established: a tax-exempt organization is taxable if the income-producing activity is: (1) a trade or business; (2) regularly carried on; (3) not substantially related to the organization's performance of its exempt function. The unrelated business income tax was enacted in response to perceived abuses of tax laws by tax-exempt organizations that engaged in profit making activities. Congress discerned a need to restrain unfair competition fostered by the "destination of income" test.[1]

---

[1] The Senate Report on the Revenue Act of 1950 states:

> The problem at which the tax on unrelated business income is directed is primarily that of unfair competition. The tax-free status of . . . organizations enables them to use their profits tax-free to expand operations while their competitors can expand only with the profits remaining after taxes. Also, a number of examples have arisen where these organizations have, in effect, used their tax exemptions to buy an ordinary business. S. Rep. No. 2375, 81st Cong., 2d Sess. 27 (1950).

By 1950, many exempt organizations were directly competing with taxable entities. The following extract from the Congressional Record illustrates the extent of this practice and the Congressional concern about it.

> "Mr. Sabath. ***A year ago one of the South's profitable textile operations was turned into a tax-exempt

(Continued)

Under the first two criteria applicable to determine whether income is unrelated business income, it is clear that the Y's provision of health club facilities and services to the community constitutes a "trade or business" regularly carried on.

Under the third prong of the test, in order to be tax-exempt, the trade or business must have a substantial causal connection to the achievement of the exempt purpose of the organization. Under the Internal Revenue Service interpretation, the Y's health club facilities are not subject to the unrelated business income tax if they provide a community benefit through access to health improvement programs and recreational facilities and services. IRSA contends that this analysis, as applied by the Internal Revenue Service, is inadequate to resolve the proper

---

foundation, involving its $34,000,000 holdings. The community gets about $400,000 in tax-exempt moneys--about equal to the taxes the company formerly paid locally. All of its other huge profit total is exempt to the Federal Treasury.

Our universities and colleges have gone into business in grand style under this strangely overlooked weakness in our laws. Union College recently purchased all of the properties of Allied Stores Corp., one of the largest national department-store chains. The same college recently acquired the Abraham & Straus property in Brooklyn for $9,000,000 and immediately leased it back to Abraham & Straus at low rentals under and 80-year lease.

"Meanwhile, the involvement of educational institutions in the field of banking, real estate, commerce, and industry goes merrily on. Universities own haberdasheries, citrus groves, movies, cattle ranches, the Encyclopidea Britanica (owned by the University of Chicago), and a large variety of other enterprises. The University of Wisconsin controls patent pools and collects royalties. Universities and colleges, together with foundations, have an annual income from their business activities of well over half a billion dollars annually. Were this income not tax-exempt, they would pay $173,000,000 in Federal Taxes annually."

97 Cong. Rec. pp. 7273-9274 (1950).

tax treatment of the YMCA's expanded health club and fitness center activities.

The original Service analysis focused on whether the Y's fitness and recreation facility was available to the community and operated in a charitable manner. Rev. Rul. 79-360 describes a section 501(c)(3) organization which provides recreational facilities and services as well as health club activities. The revenue ruling holds that the operation of the health club does not contribute, in the causal sense, to the accomplishment of the organization's exempt purposes because the annual dues charged to the health club members and a use fee charged to non-health club members are commercially comparable and sufficiently high to restrict the health club's use to a limited number of members of the community.

Based on the early IRS rulings, it could be concluded that, if the YMCA fee structure was the same or similar to the fee structure of a commercial health club in the community and the YMCA did not include features which would make the club's facilities accessible to the low income or financial needy members of the community, then the operation of the club would be subject to unrelated business income tax.

However, the IRS has significantly liberalized its position on YMCA health clubs. According to the IRS, YMCA health club income is exempt if it is shown that the recreational activities are for the benefit of a community at large. Although "charity memberships" would be a factor for consideration, there is no requirement that the Y provide special rates for low income persons or financially needy members. The IRS has ruled that, notwithstanding the absence of any provision for or assistance to less affluent or financially needy members of the community, YMCA health clubs are tax exempt. The presence of fees, even commercially comparable fees, does not detract from the relatedness of the activity.

Under the community benefit analysis, income derived from new YMCA facilities will be tax-exempt if membership in the club is a direct reflection of the community at large. IRSA asserts that IRS's expansive interpretation of charitable purpose under the community-wide benefit rationale is inconsistent with the established interpretation of this basis for tax-exemption.[2] For example, a fitness facility constructed in a wealthy community could satisfy the Service's criteria for tax-exemption even though it charged commercially comparable fees and provided no services to the disadvantaged members of the community. IRSA urges that such a facility provides no community wide benefit, rather, the tax-exempt status of the facility diverts needed funds from programs designed to benefit members of charitable classes.

---

[2] In Rev. Rul. 67-325, 1986-2 C.B. 113, the Service decided that restrictions on use on the basis of race were impermissible for a recreational facility if it was to be classified as exempt under section 501(c)(3) of the Code. Rev. Rul. 67-325 stated the community-wide benefit rationale as follows:

> Providing a community recreational facility is in the general class of purposes only where all members of the community are eligible for direct benefits, . . . in this body of general law pertaining to purposes considered charitable only where all members of the community are eligible to receive a direct benefit, no sound basis has been found for concluding that there would be an adequate charitable purpose if some part of the community is excluded except where the exclusion is required by the nature or size of the facility.

IRSA urges that the Service has expanded the community benefit rationale beyond its stated scope. The Service now permits Y fitness facilities to escape taxation even through certain members of the community are excluded by the commercially comparable fees charged by YMCAs. There is no acceptable rationale for exclusion of persons from a tax-exempt facility on the basis of inability to pay.

Section 513(c) of the Internal Revenue Code contains what is know as the "fragmentation rule". This rule states that trade or business activities do not lose their identity because they are carried on within a larger aggregate of similar activities or a large group of activities that may, or may not be related to the exempt purpose of the organization. IRSA submits that under this rule, the health club trade or business of each YMCA facility should be separately examined and analysed. In addition, section 513(c) provides that where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business should be excluded from such classification because it does not result in a profit. IRSA urges that because Y facilities are not characterized as profit-making, they should not escape classification as unrelated business activities. IRSA notes that the consolidated financial statement for YMCAs shows a 56 percent payroll expense. Taxpaying clubs average a 29.8% payroll expenses.

IRSA submits that the community-wide benefit rationale as applied to the operation of YMCA's fitness facilities is suseptible to abuse. The YMCA is positioning new facilities in wealthy communities that are already well served by tax-paying clubs, while closing down YMCAs and limiting services to poor downtown communities. In fact, it is IRSA's understanding that some Y locations have begun construction of new facilities and have evicted destitute adults who had been living at the YMCAs in those locations. These individuals will now be homeless.

In three communities, Portland, Oregon, Rock Island, Illinois, and Pittsburgh, Pennsylvania, property tax assessors have determined that YMCA fitness facilities in their jurisdictions are no longer legitimate public charities and have revoked their tax exemptions. Those communities have recognized that the Y facilities were not operated for the public good, and thus did not qualify for direct public subsidy. The Subcommittee has asked how current income-producing activities of exempt-organizations relate to government policies. The tax-exemption of income derived from activities identical to those performed by taxable organizations deprives the federal government of needed revenue and is in direct conflict with federal deficit reduction policy.

The Subcommittee has asked "Do the present-law rules permit unfair competition by exempt organizations"? Currently 78% of the clubs in our industry face a competitor that pays no property taxes, no county or municipal taxes, no state taxes, no federal income taxes; YMCAs are not required to pay payroll insurance taxes; YMCAs are allowed to market their facilities through lower postal rates; YMCAs receive tax-deductible donations from both the United Way and individuals; YMCAs are able to enlist voluntary labor; the insurance liability rates charged to not-for-profits are lower than those charged to taxable businesses; the YMCA's tax-exempt status enables it to build and expand its facilities through tax-deductible donations; and YMCAs have priviledged access to government grants.

As a result, YMCAs have a 25 percent to 40 percent cost advantage over the tax-paying fitness centers with which they compete for members. It is IRSA's view that unless such commercial activity on the the YMCA's part is subject to taxation, it constitutes unfair competition.

Consequently, IRSA urges Congress to develop meaningful criteria that ensure that tax-exempt and tax-paying athletic and fitness centers compete on equal terms, on a "level playing field". IRSA submits that the taxation of unrelated business income, as currently defined, is vague and difficult to administer. Various commentators have stated that the determination of whether an activity is substantially related to an exempt purpose is often a subjective determination. Further, the unrelated business income tax, as defined in sections 511 through 513 of the Internal Revenue Code, has not been legislatively reviewed in 37 years.

Moreover, the unrelated business income tax has proven inadequate to determine the proper tax treatment of the fairly recent phenomenon of the upscale YMCA fitness facility. Accordingly, IRSA submits that a more precise standard, and one more easily applied, would be appropriate. Thus, IRSA argues, the community-wide benefit test for relatedness is not adequate. The primary focus of a charitable organization should be on operating for charitable purposes, not engaging in income producing activities. Under current law, if the organization is primarily operated to run an unrelated trade or business, exemption may be jeopardized. IRSA recommends that Congress adopt a standard specifying that a tax-exempt organization which engages in a minimum amount of commercial activity would be deemed to be operating for other than charitable purposes. In addition, the Subcommittee should explore the possibility of developing a requirement that charitable organizations devote at least a majority of their resources to serving those in the traditional charitable classes. The Subcommittee should also explore the possibility of ensuring that a tax-exempt organization that engages in any amount of commercial activity pays income tax on receipts derived from such activity.

IRSA also submits that the current forms 990 and 990T are not adequate to identify compliance issues. The current audit program conducted by the Exempt Organizations Division of the Service is insufficient to ensure that exempt organizations are, in fact, operating for exempt purposes. IRSA suggests that tax-exempt organizations be required to report all commercial activity on Form 990T. Too often, tax-exempt organizations do not report income that should properly be characterized as unrelated business income. IRSA submits that, even if health club income is characterized as taxable, the current 990T permits Y's to improperly recharacterize expenses as allocable to this income. A uniform set of standards should be devised to ensure that income and expenses are properly allocated in this area.

Finally, IRSA submits that tax-exempt charitable organizations should be required to annually submit information that demonstrates that they are, in fact, operating for charitable purposes.

III. Conclusion

The increased emphasis in our society on health and fitness is responsible for the proliferation of tax-paying and tax-exempt health clubs. The YMCA has responded to this trend by building an increasing number of modern fitness centers. The tax-paying and tax-exempt fitness centers perform the same function and serve the same markets. Both are responding to the same market trends. However, one is subsidized by federal, state and local governments. IRSA urges that this subsidy constitutes unfair competition and that this unfair competition should be addressed by legislation and increased IRS enforcement.

On behalf of IRSA, I would like to thank the Subcommittee for the opportunity to testify on this important issue.

Chairman PICKLE. Thank you, Mr. McCarthy. Now Frank Eisenzimmer, president of the Cascade Athletic Club. Where is that, in what city, sir?

Mr. EISENZIMMER. That is in Gresham, Oreg., Congressman. Gresham is a subsidiary, just very close to Portland, about 13 miles east, population of about 50,000 people.

Chairman PICKLE. Fine.

STATEMENT OF FRANK EISENZIMMER, PRESIDENT, CASCADE ATHLETIC CLUB, GRESHAM, OREG., ON BEHALF OF THE INTERNATIONAL RACQUET SPORTS ASSOCIATION

Mr. EISENZIMMER. Good morning. Thank you for this opportunity. In 1960, I became a firefighter in the city of Portland and because of the fact that the fireman works 24 hours on and 48 hours off, I was able to hold a second job. I worked for the Portland Fire Department for 17 years and I worked two jobs that entire time. My wife also was a secretary, a legal secretary. By 1977, after 17 years of working two jobs and my wife working, we raised enough capital to open the Cascade Athletic Club in Gresham. At that time, we did our own contracting, drew our own plans, and built a 24,000-square-foot facility. As a couple of years went by, we added to that facility, added indoor tennis, et cetera, and we had a 100,000-square-foot club with 4,200 members. We were the only club in the community and provided a very nice amenity for that. We took a 5-acre cow pasture and turned it into a $5 million club. We employed 45 people and we paid taxes of $75,000 on that property last year, besides providing the jobs and the income, et cetera.

The club that we have now, the 100,000-square-foot club has seven indoor tennis courts, two gymnasiums, 7,500-square-feet of work-out area, indoor tracks, outdoor tracks, indoor pools, outdoor pools, hair styling shops, restaurants, and many, many other facilities, karate, ballet, et cetera. About the time we opened the Cascade Athletic Club in 1977, the Columbia Wilamet YMCA of Portland, was also constructing their Metro Fitness Center in downtown Portland. This club was designed for the executives in the downtown city area. At that time, it was not a big concern to me because they were 12 miles away and I did not see them as competition for my market.

In May of 1983, an article came out in our local paper which stated—the article I have here, it is also in the packet that I handed out—Gresham Throws Out Welcome Mat for New YMCA Programs. They were going to give 2 acres to the YMCA to build an athletic club a mile and a half east of my facility. Just a short while after that, an article came out in the Portland Oregonian that an $8 million YMCA was going to be built 5 miles west of my club on the new transit mall, which was midway between Gresham and Portland. Gresham is a bedroom community and many of our members are people who work in the city of Portland. It was also at the intersection of our two major freeways, so it was going to provide a tremendous amount of competition for me.

I could actually see myself going out of business with one Y on each side of me of this magnitude. We are talking multimillion dollar, $8 million facility here. I saw this as unfair competition because of the fact that the YMCA had a figured status. They were receiving donated building funds. They did not have to pay taxes. They had an excellent location which I could not get. It was the YMCA that got that because of their status in the community. They had free public service ads on television and newspapers. They received mass mailings for two-thirds less cost than I did. They were receiving 10 percent of their budget from United Way. I could not compete with this.

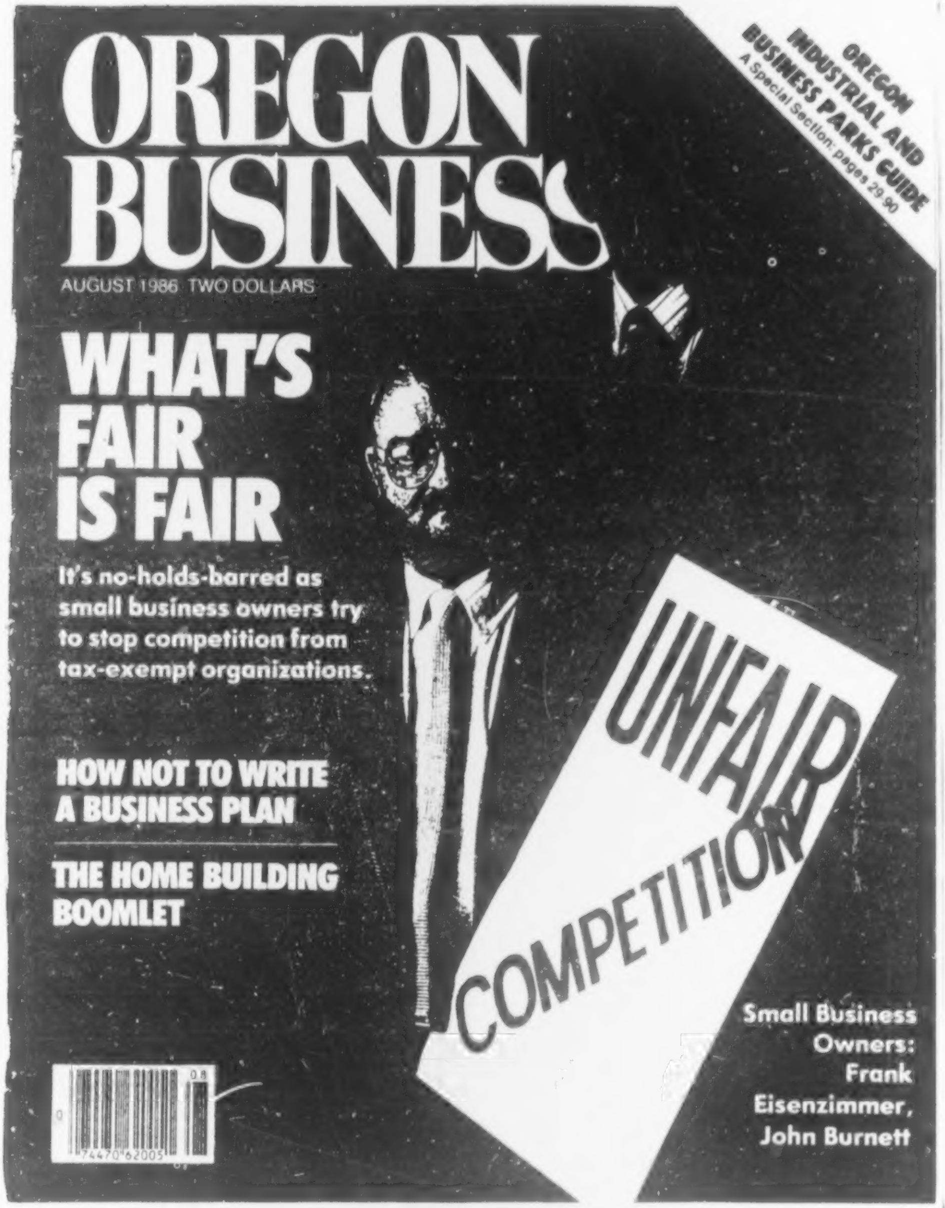
To make matters even worse, about this time, the YMCA came out with a brochure that said, Come Watch Us Grow. You also have this in your packets. The Come Watch Us Grow brochure said that the YMCA was going to build eight new athletic club facilities in the Portland-Vancouver, Washington area by the year 2000. This would have completely devastated the private club market in our area. With that, I formed an organization of 26 athletic clubs in southern Washington and Oregon. We called it the Northwest Alliance for Market Equality, acronym of NAME. We hired an attorney and we hired a lobbyist to go down to the legislature and speak for us. We were denied access to the YMCA's budget records. We were not able to get those until we finally sued the county tax assessor and, through litigation, were able to acquire those records. I have a copy, as you do in your packet, of the YMCA Metro Fitness Center budget.

We heard here today from the YMCA that they were receiving a lot of community support. The Metro Fitness Center, if you will look on the first page, in 1986, received less than 1 percent of its total operating budget from contributions. Only 0.7 percent; 99 percent of the Metro Fitness Center's funding came from fees for services. If we look on the next page, we also see that the YMCA's received, that particular club, made a 21 percent net profit. Upon suing the county tax assessor in Mamola County, he researched the records and what was going on with the YMCA and although we only sued him on the Metro Fitness Center, he actually put all five of the properties in Mamola County on the tax rolls, even Camp Collins, which is a children's camp, which he found that only 15 percent of the kids going to that camp were on scholarships. The other 85 percent were paying.

Right now, in Portland, Oreg., the YMCA cannot raise enough funds to build, I would say, even a garage at this point. Public awareness, over the last 4 years, from the television and media coverage that we have had, the YMCA has just cancelled its $8 million facility, due to the fact that it could not raise the funding. We do not consider the YMCA as bad; it is good for the community; we complement them on many of their programs, but, as we have said before, we believe we should play on a level playing field. We both do exactly the same things. Our barbells are as heavy as the Y's. Our water is just as wet.

We also provide a lot of benefits for the kids. We have over 800 kids going through our swimming program this year. We have senior citizen programs that are free. We have kids summer camps, $40 for 8 weeks. They get a T-shirt, they get a free picnic at the end of that. It is not a moneymaker. We do a lot of community service. Our taxes do not go down a hole. They were talking about all the services that the YMCA provides. When a private club bills and provides all these tax dollars, those go for social good also. Thank you.

[Attachments to Mr. Eisenzimmer's statement follow:]



OREGON BUSINESS

AUGUST 1986 TWO DOLLARS

OREGON INDUSTRIAL AND BUSINESS PARKS GUIDE
A Special Section: pages 29-90

WHAT'S FAIR IS FAIR

It's no-holds-barred as small business owners try to stop competition from tax-exempt organizations.

HOW NOT TO WRITE A BUSINESS PLAN

THE HOME BUILDING BOOMLET

Small Business Owners: Frank Eisenzimmer, John Burnett

COVER STORY

WHAT'S FAIR IS FAIR

It's developing into a no-holds-barred fight on several levels as small business battles competition from tax-exempt hospitals, charities, and from state agencies.

BY ROBERT L. HILL

Harry Czyzewski got so mad about it that after 40 years as a member, he quit the Portland Chamber of Commerce in protest.

When John Burnett started his one-man crusade against it, an Oregon State University (OSU) professor publicly accused him of being disloyal to his alma mater.

When a group of Ashland motel owners went to court to stop it, they were picketed by college students and subjected to a boycott that continues today.

And with the conversion of his local protest against it into a national movement among athletic club owners, Frank Eisenzimmer's name has become a four-letter word among YMCA officials, both inside and outside Oregon.

All these small businessmen and others like them engaged in similar actions say they know they have taken on some of the most powerful "sacred cows" in society. Nevertheless, the best way to sum up their current attitude is to paraphrase a couple of well-known movie actors: frankly they don't give a damn; they're mad as hell and they're not going to take it any more.

The "it" that all these business people are protesting against is what they perceive to be unfair competition by tax-exempt organizations and government agencies.

The individual circumstances surrounding each business person's claim of unfairness differ a great deal. But in general the claims break down into two categories. First, some not-for-profit, pri-

AT ODDS: Beaverton pharmacy owner Stan Hartman (left), took Kaiser Permanente to court over nonprofit drug dispensing. Frank Eisenzimmer (above), owner of a Gresham athletic club, believes posh YMCAs like the multimillion dollar RiverPlace complex under construction in downtown Portland (right) should no longer qualify for tax-exempt status.

vate organizations are being accused of using their tax exemptions, originally given them to perform charitable acts or community service, to instead gain a price advantage for their services in the commercial marketplace, largely foregoing charity in the process. Second, some governmental operations are being accused of using taxpayer subsidization to engage in low-cost -- and in some cases illegal — competition in the marketplace.

The unfair competition issue seems to be snowballing on both the national and state levels. At the first White House Conference on Small Business held in 1980, Burnett, who is owner of Chinook Research Laboratories in Lebanon, was one of the few among the 2,000 delegates at the Washington, D.C., conference who was concerned about the issue. This year, six of the 27 resolutions passed by the Oregon conference on small business concerned the issue. And because 42 states have passed resolutions on the issue this year in their conferences, "unfair competition" automatically becomes one of the top subjects that will be debated at the Second White House Conference on Small Business being held later this month in Washington, D.C. Burnett is vice chairman of the 24-member Oregon delegation to that event.

Also, the federal Small Business Administration became actively involved in the issue in 1983 when it published a report titled "Unfair Competition by Nonprofit Organizations with Small Business: An Issue for the 1980s." That report attempts to define the problem and describe some of the more blatant examples of what many small business people would consider unfair competition.

On another front, in 1984 several Washington, D.C., trade associations formed the Business Coalition for Fair Competition to address the issue on the national level. Members include the American Association of Nurserymen, the American Consulting Engineers Council, the American Council of Independent Laboratories, the American Society of Travel Agents, the American Veterinary Medical Association, the International Racquet Sports Association, and the National Hearing Aid Society.

In Congress, the coalition plans to be actively involved in hearings on unfair competition that the Ways and Means Committee of the U.S. House of Representatives plans to hold later this year. Also, the conference committee trying to hammer out a new federal tax structure is debating whether the Blue Cross/Blue Shield organizations have become too similar to commercial health insurers to qualify any longer for a tax exemption.

Into The Oregon Legislature

For its part, the 1987 session of the Oregon Legislature will be tackling part of the subject as it deals with legislation that will attempt to clearly define what constitutes a charity for the purposes of tax exemption.

Ironically, the reason the topic is emerging full-blown in the Oregon legislative arena is that several small business people, tired of complaining to no avail to their elected officials, went to court and, in several cases, won.

Of all the claims of unfair competition over the past few years, Eisenzimmer is the individual most responsible for pushing the issue into the public limelight. (See story, page 16.) Eisenzimmer, who is president of Cascade Athletic Club in Gresham, and other club owners in the area became upset in 1983 when they discovered that the YMCA planned to build a $7.5 million facility at the site of the new Gateway light rail transit station, in east Multnomah County, despite the presence of several nearby private clubs that were not at their membership capacity. The club owners tried unsuccessfully to prevent Tri-Met from leasing land for the new club to the Y at very favorable lease rates.

Then the club owners, organized into a group called Northwest Alliance for Market Equality (NAME), challenged the property tax exemption of the downtown Portland Metro Center YMCA, claiming it was a "commercial, members-only health club" which did not "substantially contribute to the furtherance of its charitable goals, if any."

In a decision handed down by Multnomah County Tax Assessor C.R. Sheffield last December, NAME won in spades. Not only did the tax assessor place the Metro Center YMCA on the tax rolls, but he also ruled that the YMCA was only spending 11% of its Multnomah County operating revenues on charitable purposes and that this level did not qualify the YMCA for any property tax exemption. He placed all YMCA property in the

PHOTOGRAPHS BY KENT WALTH

HEALTH CLUB OR CHARITY?

Any reporter who gets on Frank Eisenzimmer's mailing list will need to get a bigger mailbox.

He inundates media people with stories on: new luxurious YMCAs being built in Los Angeles, Dallas, and other major cities; tax exemptions being taken from YMCAs in Illinois; a gourmet restaurant going into a Toronto YMCA; court cases from Utah where tax exemptions were taken away from two not-for-profit hospitals; and numerous position papers disputing claims made by the YMCA about why it deserves tax exemptions.

Eisenzimmer first contacted this magazine almost three years ago about doing a story on his battle with the YMCA. *Oregon Business* declined, because the story seemed to be covered adequately in the daily media. But because of Eisenzimmer's persistence, we started to be on the lookout for other instances of alleged unfair competition by not-for-profit organizations. The result is this package of stories on pages 14-23.

Eisenzimmer is articulate, outspoken, very persistent, and knowledgeable about the media. In addition, he can speak with the authority of having turned an open field into a successful business — the 100,000-square-foot Cascade Athletic Club in Gresham. In short, he's a small business Lee Iacocca; he is good at the one thing that small business owners are almost uniformly bad at — media relations.

He possesses a talent for coming up with that extra little "twist" that will turn a long-running battle over tax assessments — basically dry subject matter to say the least — into a news story with some "pizazz." To accomplish this, he has at times resorted to tactics such as picketing YMCA annual meetings or to placing controversial messages about the Y on the big message board outside his club on Division Street. These tactics have worked at gaining him the publicity he wants.

But perhaps the greatest reason Eisenzimmer has been effective in getting his message across is that he doesn't convey any trace of the phony media huckster. When he says he is a staunch believer in the free enterprise system and that organizations which do not provide a significant charitable benefit to society should not receive tax exemptions, the listener does not doubt that Eisenzimmer means what he says and will do everything in his power to achieve his goal.

That goal, quite simply, is to get all tax exemptions removed from Y facilities designed and built to cater to the middle- and upper-middle classes and their families. These people can afford to pay for a private health club and should not be subsidized at the expense of other taxpayers, Eisenzimmer contends.

If the YMCA wants a tax exemption, it should revert to providing only low-cost or no-cost fitness programs to the poor and disadvantaged, Eisenzimmer says. He adds that the YMCA should be concentrating its programs on providing services to areas like the poor neighborhoods of northeast Portland, not in expansion to the suburbs and in building a multimillion-dollar YMCA at the new RiverPlace condominium development in downtown Portland, a Y that will offer classes in sailing, water skiing and sailboarding — "hardly the pastimes of poor kids."

Eisenzimmer says the Y should concentrate on services to the poor, not on sailing classes. Officials of the YMCA say club owners object to the middle class having the chance to "market shop" between for-profit and not-for profit services.

YMCA officials counter Eisenzimmer by saying all Y programs, not just its programs for the disadvantaged, provide a community service. Thus the Y deserves its tax exemptions.

As an example of its community orientation, Leslie Haines, director of communications for the YMCA of Columbia-Willamette, which has facilities in the three Oregon counties of metropolitan Portland and in Clark County, Washington, pointed out that 58,428 people participated in that Y's programs last year. Of that total, 32,712 were nonmembers and 26,874 were youth.

Eisenzimmer says most of the nonmembers in Y programs pay to take part, and most could afford to pay at rates "not subsidized by the taxpaying public."

Haines said there is a "certain amount of sour grapes" in the complaints by private club owners. She said the club owners are "not at all unhappy to see us provide service to the portion of the population it is not profitable to serve. What they object to is us giving the middle class the chance to market shop between for-profit and not-for-profit services."

She added that most people in the community don't know how charitable organizations are funded currently, with the primary sources for funds being fees for service and government contracts. Without these funds, she said, most nonprofits "would go out of business." (See accompanying charts.)

YMCA officials also say that their organization has been providing fitness programs for over 100 years and that private health club owners invaded the Y's domain and then started complaining about "unfair competition."

Eisenzimmer says YMCAs were "dingy, hole-in-the-wall" gyms until private club owners built nice facilities for the middle class. Then the YMCA decided the only way it could expand was to build equally luxurious clubs to serve the same clientele.

The court battle between Eisenzimmer and his alliance of private club owners and the YMCA could be a precedent-setting case on a national level. Thus, the International Racquet Sports Association, a Massachusetts-based trade association of private clubs, has promised to foot the legal bills for the Northwest club owners.

In the course of this legal battle, Eisenzimmer has become almost a media celebrity, speaking at national conventions and being quoted in newspapers and on television and radio stations throughout Oregon, in national trade publications, and even in such prestigious newspapers as *The Wall Street Journal* and the *Los Angeles Times*. *The Wall Street Journal* article, on the front page of its second section, ended by quoting Eisenzimmer: "I took a cow pasture and I've turned that into over half a million in taxes over the last eight years. If the YMCA is truly interested in helping the community, why won't they pay their taxes in the first place?"

At the same time, Eisenzimmer has also thrown his efforts into helping private club owners with similar problems in other parts of Oregon. He sent letters to the Bend newspaper protesting a plan to build a taxpayer-financed sports complex, since there was a private club in Bend, and the club owners' alliance also protested a proposal for a YMCA in Hermiston, where a private club also operates. Both proposals died.

Steve Watkinds, owner of the Columbia Court Club in Hermiston, said, "The idea (for a Y) was silly for a town this size. I smashed the idea quickly here, in part because I had done a good job of covering all the local political bases."

Meanwhile, Eisenzimmer was covering all the media bases.

county — three branches and Camp Collins — on the tax rolls.

The assessor came up with his 11% figure by comparing the total amount of charitable funds raised by the Y — from the United Way, donations by its own members and outside donations — to the operating budgets of the four facilities. When the assessor computed how much of the Y's budget went to "direct scholarships" to pay for use of Y facilities by those who couldn't afford to pay to use them, he came up with a figure of 3 6%. "Based on these percentages of monetary resources expended, it does not appear that the primary use of the properties is charitable," the assessor said in a formal memo explaining his decision.

Using the lowest of two recent appraisals of YMCA properties, the assessor determined the Y owes $969,802 in real estate taxes for the seven tax years of 1979-80 through 1985-86. The YMCA has appealed the decision to the state Revenue Department.

Then last year another small businessman, Ted Tosterud, owner of Northwest Medical Laboratories of Portland, used a similar tactic against four Portland area not-for-profit hospitals. (See story, page 20.) He challenged the property tax exemptions for the hospitals' laboratories, because the labs were actively seeking business from nonpatients of the hospitals in competition with several private labs. Sheffield recently ruled against Tosterud, who now plans to appeal the decision to the Revenue Department. Both Tosterud and Eisenzimmer used the same attorney in their cases, Michael Morris of the Portland law firm of Grebe, Gross, Peek, Osborne & Dagle.

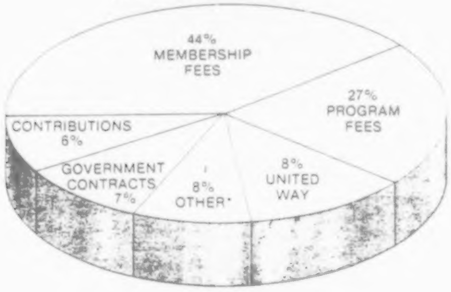
In the wake of these court battles, both sides plan to take the issue to next year's legislature. While the Oregon law is very specific in providing tax exemptions for certain organizations by name — for instance fraternal organizations like the Elks and Moose — the law is very vague in defining what constitutes a charitable organization for purposes of tax exemption. Both sides are already organizing for the fight. The YMCA, the Oregon Association of Hospitals and the United Way have formed a coalition to push for a definition of a charitable organization that will work to their interests. At press time, the three organizations were still negotiating to come up with a definition that all three organizations could agree to.

As an example of the emotion and complexity surrounding the issue, personal opinions differ widely, even within the nonprofit coalition itself. A top official of a Portland charity, refusing to be quoted by name, said he thought the YMCA deserved to be tax-exempt, but that not-for-profit hospitals "will have a tough time proving their case in higher courts. They're nothing more than big

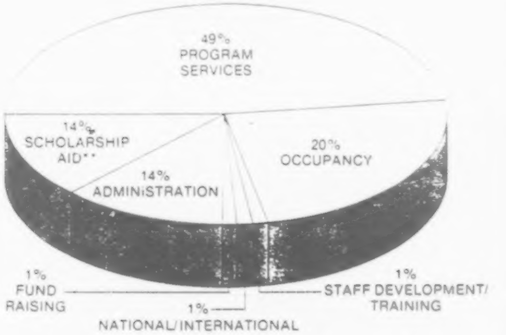
YMCA FINANCES

(FOR YMCA OF COLUMBIA-WILLAMETTE)

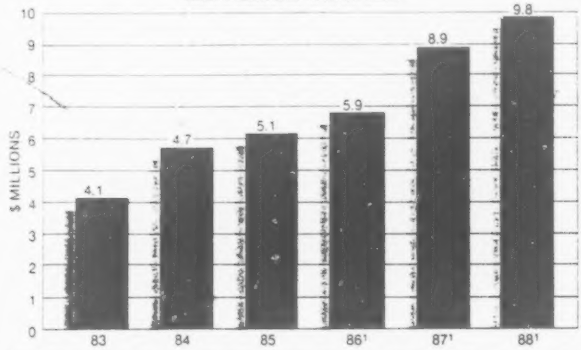
REVENUE SOURCES



EXPENSES



REVENUE TOTALS



*The "Other" revenue category is primarily interest from the YMCA's endowment. **The Multnomah County tax assessor, disallowing certain expenses that the Y said should be classified as charity, determined that only 11% of the YMCA's Multnoman County operating budget went to charitable purposes. [1]Estimates. The big jump for 1987 revenue total occurs as a result of the completion of the RiverPlace YMCA.

Source: YMCA of Columbia-Willamette.

businesses." And a high official of one of the four hospitals sued by Tosterud, also refusing to be quoted by name, said hospitals clearly deserve their tax exemptions, but that the YMCAs will probably lose their tax-exempt status because "they operate just like Yuppie health clubs now."

David Paradine, president of the United Way of the Columbia-Willamette, said his organization has joined the coalition because of concern that a charitable organization might be defined so narrowly that many of the approximately 100 member agencies of the United Way would fail to qualify. Paradine noted not-for-profit organizations have always competed against for-profit businesses, but that the competition has become more intense as government funding of community programs has been cut back.

Has Health Care Improved?

In an interview, Morris noted that perhaps the issue is best decided by the legislature, but that it will be difficult to deal with because so little actual data exist on the scope of the problem. "Tax assessors have never done any monitoring of the use of nonprofit exemptions," Morris said. "Nonprofits have expanded into the private sector, and no one has objected until now . . . There is no real good handle on how much of their income nonprofits derive from competitive enterprises."

Morris said a good question could be raised as to whether hospitals are nonprofit entities at all, because they regularly report surpluses that are then plowed back into the organization for expansion and purchase of new equipment. As just one example of this, Healthlink, a nonprofit organization comprised of Emanuel, Meridian Park, Physicians & Surgeons, and Mount Hood Medical Center hospitals, reported net income of $11.6 million on revenues of $132.7 million in its 1985 fiscal year.

In the case of hospitals, Morris said, the legislature should, in determining whether hospitals qualify for nonprofit status, ask whether the quality of health care has improved because of that nonprofit status and whether health care is cheaper as a result, or, conversely, whether nonprofit hospitals have "simply been allowed to expand at taxpayers' expense and then compete with taxpayers who run businesses."

There is a real dearth of financial data on Oregon nonprofit corporations. A state Revenue Department spokesman said there are no data available on how much tax-exempt property there is in Oregon or how much income tax-exempt organizations collect from commercial enterprises. Sheffield said his estimate is that there is $4.5 billion of tax-exempt property in Multnomah County, including property owned by government agencies and tax-exempt private organizations. This compares to about $18 billion in property that is on county tax rolls. But Sheffield cautioned that he was only making a "rough guess."

The corporation division of the Oregon Department of Commerce reports that there are 14,892 nonprofit corporations headquartered in Oregon at present and another 335 nonprofit corporations operating in Oregon whose headquarters are out-of-state. This is an increase of 466 nonprofit corporations in the last two years, as far back as data go. This is out of a total of between 70,000 and 80,000 corporations, both for-profit and nonprofit, and limited partnerships in Oregon.

KENT WALTH

PROFIT ADVOCATE: Attorney Michael Morris has tried two cases challenging tax exemption of nonprofit operators

A major sticking point in the legislative battle will be whether an organization defined by law as "charitable," such as the YMCA or nonprofit hospitals, will have to give some specified percentage of its revenues to the needy to gain tax-exempt status. Officials of the United Way, nonprofit hospitals, and the YMCA all oppose any stipulation of this type.

G. Rodney Wolford, president of Healthlink, said that the changed nature of hospitals into a high technology, high cost business makes impractical any mandatory revenue limit for charitable service. It would be nearly impossible to find a percentage figure that would apply to both hospitals and charities like the Salvation Army, Wolford said.

On the other hand, P.D. Fleissner, president of the Oregon Association of Hospitals, says not-for-profit hospitals that have received federal funds, known as Hill-Burton funds, to build new facilities have had to accept federal regulations on a mandated amount of charity care. These require a hospital to give 3% of its gross revenue or 10% of the amount of the Hill-Burton grant, whichever amount is larger, to charity care. The 45 hospitals in Oregon that have accepted Hill-Burton funds have had no trouble meeting that regulation, but consider many aspects of the regulation unfair to taxpayers, Fleissner said. For instance, under Hill-Burton regulations a hospital may have to give free or discount care to a college student, even though the student's parents could afford to pay the full cost. Similar problems could occur with state regulations on a required amount of charity, Fleissner said.

Leslie Haines, director of communications for the YMCA of Columbia-Willamette, the YMCA organization for the Portland metropolitan area, said the Y has its tax exemption because all its programs, not just those that serve the needy, fulfill a community need.

Eisenzimmer counters that by noting, "People get just as healthy by using my facilities as those at the Y. My barbells weigh the same as those at the Y. If the basis of tax exemption is to be making people more healthy, then my business is entitled to a tax exemption."

If any new law defining charity does not contain a specified level of contribution to the needy, officials of not-for-profit hospitals, the hospital association, the Y and the United Way admit it would be possible to abuse the law by converting a for-profit business to a nonprofit status. A business owner could put his or her friends and relatives on the board of directors and receive a large salary for running the business. Nevertheless, officials of the not-for-profit sector say this type of abuse could be prevented through the proper enforcement of the law.

But Stan Hartman, executive director of the Portland Retail Druggists Association and part owner of Bel Aire Pharmacy in Beaverton, said if the current competitive situation between not-for-profit and for-profit pharmacies is not rectified soon, many smaller pharmacies will consider incorporating as nonprofit organizations. For 17 years, the Portland druggists association has been fighting in court to keep the sale of drugs by nonprofit hospital pharmacies restricted to patients of those hospitals. (See story, page 21.)

Paradine of United Way said any definition of charity adopted by the legislature should include the following elements: the organization should meet all the federal criteria for a tax-exempt organization by having a volunteer board of directors and not allowing the proceeds of the organization to benefit the board members or staff; services should be priced on a sliding fee scale based on ability to pay for those can pay and provided free to those who can't afford to pay anything; the same quality of service should be provided to everyone, regardless of how much, if anything, the person pays for the service; and the organization should have to show that there is a broad range of support for it within the community.

Fighting The Establishment

Paradine said tax exemptions do not provide a big advantage in the marketplace for not-for-profit organizations such as the YMCA or the United Way. "The biggest advantage we enjoy is our volunteers," Paradine said. "We can draw on the help of our unpaid, volunteer board members and we can also go to community organizations and business and ask for free help." Because many of a community's top lawyers, businessmen and other professionals often serve on boards of directors, committees, and advisory councils of these not-for-profit organizations, they are often willing to provide help gratis while a small business would pay dearly for the same services.

The small business people agree that the high-level board membership and volunteer work for many of these organizations gives them certain advantages. For instance, they become such an accepted part of the community that most small businesses are afraid to challenge them out of fear of becoming a social outcast and losing many customers. "It's like we're attacking mom, apple pie and the American flag," said Burnett, who for years has charged that the soils testing

ASHLAND'S HEARTBREAK HOTEL

Leo Jensen, an Ashland motel owner, says people in the town have called him everything from a rebel to a communist for his suit against Southern Oregon State College (SOSC).

Jensen is one of the leaders among a group of five motel owners, one taxi company and a caterer that took SOSC to court for its program of renting out dorm rooms, with meals and transportation to the Shakespearean Festival included, to festival goers.

The group members started their efforts to stop the program several years ago. They first went to the college administration, then the State Board of Higher Education, and then the legislature. When none of these would help, they took the college to court.

Last January the group won in a Marion County Court. ("We needed a neutral site for the trial," said the group's attorney, Robert Ackerman from Lane County.) The judge issued a restraining order against the program, but SOSC continues to operate it while the State Board appeals the decision.

Ackerman said the judge ruled that SOSC could only rent the rooms to Oregon high school or grade school students attending the festival as part of a school-sponsored educational program or to senior citizens in an Elderhostel educational program. Ackerman said the SOSC program was in violation of state law because the legislature has never given the State Board the authority to run its dorms for this type of use. From a legal standpoint, the case was simple to prove, Ackerman said.

Ackerman noted that SOSC remodeled one of its dorms to make it more appealing to tourists. This included the installation of an elevator. People could stay in the dorm for seven days, including meals, for under $200. "It was the southern Oregon version of Club Med," Ackerman said.

MARK PYNES

LEADER: Motel owner Leo Jensen fought against summer dorm rentals in Ashland.

Over the years, annual revenues from the summer dorm rentals have grown from about $275,000 in 1982 to $750,000 last year, according to Jensen. He added that the amount going into the community would be twice that if people using the dorm had stayed in private motels, because charges by SOSC "don't include overhead, property taxes or insurance."

Officials at SOSC refused to comment on the case because it is in court. They referred all questions to the state Attorney General's office, which is handling the appeal for SOSC. Jerry Lidz, assistant attorney general, said all the activities challenged by the motel owners "are part of the college's educational and service mission." He said the motel owners are asking the college not to do its job "because they don't like the competition." If the argument by the motel owners was carried to its extreme, he added, then all public colleges and universities would have to close because private colleges could do everything public colleges do.

Without the SOSC program, Jensen estimates that the occupancy rate for his 21-room motel would be 20% higher. Ashland city officials have permitted the building of too many motels, he complained, so that now on a year-round basis Ashland has the lowest lodging occupancy rate in the state. "It's really dead around here nine months of the year. You have to make your money in the summer."

Jensen came to this country from Holland. From his struggle against SOSC, Jensen says he has learned that "you have to stick to your guns, but don't count on the politicians and trade associations who are supposedly there to help you." Jensen still believes the American people in general are very understanding and have a lot of common sense, but that this country could be "in deep trouble" unless more support is shown for the free enterprise system.

HEALTHY COMPETITION

Ted Tosterud says he is not conducting a vendetta against not-for-profit hospitals. "I'm not mad at the hospitals. I'm just upset with the law."

Tosterud, who owns Northwest Medical Laboratories of Portland, has challenged the tax exemptions of the medical testing laboratories of four Portland area not-for-profit hospital organizations. Because those labs actively solicit nonpatient business and conduct several millions of dollars worth of nonpatient tests each year in competition with privately owned for-profit labs, Tosterud contends those labs should not be tax-exempt. The Multnomah County tax assessor recently ruled against Tosterud, saying that the hospitals' income from those labs was only incidental and that the labs were a necessary component of the hospitals' mission to provide community health care. Tosterud is appealing the decision to the state Revenue Department.

Tosterud also charges that the hospitals are using their inpatient laboratory fees to subsidize their outside work. As examples, he says the inpatient fee for one lab test at Good Samaritan Hospital is $74.25; the same test for an outpatient is $15. At Providence Hospital, one test for inpatients costs $35; the same test for outpatients is $10.

The hospitals use the low fees to drum up business and also keep their revenues from outside work low, compared to inpatient work, Tosterud said. The Internal Revenue Service has ruled in past cases that if lab revenue from nonhospital patients becomes too substantial a part of the lab's total revenues, the laboratory can become subject to unrelated business income (UBI) tax.

Officials of the not-for-profit hospitals defend the fee differential, contending that inpatient tests cost more because the hospital must provide the person to draw the sample from the patient and often must process the sample on a rush basis.

Tosterud says the delivery of health care and the hospital business has changed a great deal since nonprofit hospitals gained their tax exemptions many decades ago. "There is a difference between providing charity, which is a gift, and merely having bad debts which you write off as charity. Every business has bad debts."

In addition to the legal fight over nonprofit hospitals' tax exemptions, Tosterud also has helped set up the Oregon Independent Laboratory Association to represent the interests of private for- profit labs in the political arena, particularly in next year's legislative session.

To P.D. "Pete" Fleissner, president of OAH, the controversy is nothing new. He said every legislative session since 1953 has had at least one bill that would have limited in one way or another the tax-exempt status of not-for-profit hospitals.

Not-for-profit hospitals traditionally have been tax-exempt because they perform a community service that government otherwise would have to perform, Fleissner said.

In Oregon, not-for-profit hospitals operate the unprofitable and more costly services such as the burn center and neonatal intensive care wards, he said. Also, nonprofit hospitals usually have provided a somewhat higher percentage of their care to charity patients than for-profit hospitals. Nonprofit hospitals also argue, Fleissner said, that their rates are lower than for-profit hospitals, "but I'm not sure that's true."

In Oregon, a hospital's average revenue write-off is 17% for charity cases, bad debt, and "contractual" write-offs. This 17% equals $205 million, because Oregon hospitals are currently a $1.2 billion-a-year industry.

> **"There is a difference between providing charity, which is a gift, and merely having bad debts which you write off as charity. Every business has bad debts."**

Contractual write-offs, which constitute about half the 17%, are ascribed to government programs sucn as Medicare and Medicaid. The hospitals contend that these programs pay less than the value of the services they receive.

As one example of the problem with government programs, Fleissner said the state Adult and Family Services Division only pays 59 cents on the dollar for care for welfare patients. The state won't pay for any hospital stay of longer than 18 days. The problem, according to Fleissner, is that legislators won't fund the hospital care program "because they know damn well we (hospitals) will take care of them (welfare patients) anyway," since by law not-for-profit hospitals cannot "discriminate based on ability to pay."

However, if the legislature takes away tax exemptions, then some hospitals may have to deny access to people who cannot pay for the cost of their care, Fleissner predicted, because there is "a financial limit beyond which hospitals cannot go." If and when that happens, he said, "Then it will hit the fan."

Fleissner sees the real problems occuring in low income and rural areas. The Harney County Hospital is having to write off about 24% of its gross revenues and "is up against the wall. And you don't see any for-profit hospitals clamoring to get into Burns." Two hospitals, one in Pendleton and one in Toledo, closed within the past year, and there are now 78 hospitals in Oregon compared to 85 a few years ago.

Some hospital officials are outspoken on why they deserve tax exemptions. Jeffrey Selberg, executive vice president and chief of operations for Portland's Good Samaritan Hospital, said for-profit hospitals are not leading the fight over the tax status of nonprofit hospitals because they want to keep a low profile on the issue of charity care. "Why isn't Woodland Park (Hospital) suing us?" Selberg asked, "Because if they did they would be under a great deal of pressure to provide more indigent care." (Woodland Park and Eastmoreland are the Portland area's two major for-profit hospitals. Both are owned by American Healthcare Management, Inc. of Dallas, Texas.)

Disputing Selberg's opinion, Wally Piekarczyk, acting administrator and chief financial officer for Woodland Park Hospital, said Woodland has a write-off of charity care and bad debts of 7%, just about the same as the Oregon average. He said no hospital, either for-profit or not-for-profit, can turn patients away because of an inability to pay and expect to be accepted in the community.

Piekarczyk said he has also worked for not-for-profit hospitals, and the methods of operation for both types of hospitals are quite similar. The main competitive advantage he sees for not-for-profits is that they don't pay income taxes, while the main competitive advantage of for-profit hospitals is that they have a much easier time raising capital. He said Woodland's parent company has just put $12 million into refurbishing and upgrading the hospital, and no nonprofit company would have been able to justify a similar expenditure, given Woodland's past performance.

He added that pressure is definitely building over the issue of tax exemptions for hospitals as health care moves "more and more into a market-controlled environment." However, he added, competition between for-profit and not-for-profit hospitals is "not necessarily fair or unfair. It's just one of the facts of life."

laboratory on the OSU campus has been using taxpayer subsidies to compete against him for business. (See story page 22.)

Czyzewski of Portland, a retired metallurgical engineer who still does independent consulting, complains that even business groups are too deferential to nonprofit institutions. He said the Portland Chamber of Commerce formed a small business group in the early 1980s to address the particular concerns of small business. As one of its first tasks, that group researched what Portland State University was doing in competition with for-profit businesses. It identified 10 different competitive enterprises, including such things as printing, and wrote a letter to the president of PSU, Joseph Blumel.

According to Czyzewski, Blumel responded by saying that the enterprises identified in the letter were vital to the functioning of PSU, and it would have to continue them.

Then, at its next board election, the Portland chamber elected Blumel to its board of directors. "And he wasn't even a businessman. That's how small business is represented by the chamber," Czyzewski said. He quit the chamber in protest after 40 years as a member.

In a similar vein, in Ashland a group of motel and other small business owners took Southern Oregon State College to court in the early 1980s. They charged that its summer program of renting out dorm rooms to attendees of the Shakespearean Festival was in violation of state laws. (See story, page 19.) "There are two

A HEADACHE FOR DRUGGISTS

Stan Hartman says if the federal government is going to continue to give government-operated and other not-for-profit health care institutions ongoing major market advantages, then the government "should take over the whole health care field. . . . Under the present system, people like us (independent druggists) are extraneous. We're almost a nuisance."

Hartman is part owner of Bel Aire Pharmacy in Beaverton and executive director of the Portland Retail Druggists Association. Since 1969, his group has been taking drug manufacturers and the pharmacies of not-for-profit organizations to court because of abuses the druggists see in the current wholesale pricing system for prescription drugs.

Under a federal law passed in the 1930s, drug manufacturers are allowed to sell their products at lower rates to nonprofit pharmacies. Hartman said the price differential averages 40% to 50% across-the-board, and in the case of some items is much more.

For instance, a month's supply of one brand of birth control pills is sold to nonprofit pharmacies for between 65 and 95 cents. It costs Hartman $10.81.

"A millionaire's daughter who is a student at Oregon Health Sciences University could get her birth control pills there for less than a dollar, while a girl working at minimum wage in a fast food stand would have to work half a day to pay for pills at my pharmacy. It isn't fair . . . ."

With this large a price differential, Hartman said he is concerned that the "pharmaceutical manufacturers are lying through their teeth" about how much it actually costs to produce their products, thus forcing his customers to subsidize nonprofit pharmacies.

As another example, Hartman pointed to recent stories in the daily press describing how 12 Oregon counties will get extra supplies of certain childhood disease vaccines for their public health departments because private doctors are referring patients to public health clinics for vaccines. Doctors are making these referrals because the county can get the vaccines much more cheaply. Drug companies have recently raised prices on several vaccines, citing the cost of liability insurance. For instance, the cost to a private doctor for one brand of DPT (diptheria, tetanus and whooping cough) vaccine is $171 for a 15-dose vial. The cost to the state is $45.15 per vial.

An average of 2.5 independent pharmacies goes out of business every day in the United States "and nobody seems to think about those jobs."

Most nonprofit pharmacies are located in hospitals, and the law requires them to generally restrict their sales to hospital patients. But one organization that has avoided that restriction is Kaiser Permanente. Kaiser has pharmacies in each of its two Portland hospitals, in 11 free-standing clinics in the Portland area, and one mail-order pharmacy. In its most recent case, the druggists association took Kaiser to court but a federal lower court judge found for Kaiser, ruling the clinics were an intrinsic part of Kaiser's health system. Hartman said the case is about to be settled out of court rather than be appealed, but he could not disclose terms of the settlement at this time.

Kaiser officials also refused to comment on the case. But Raymond Robertson, acting regional support services manager for Kaiser, said Kaiser does not consider itself as in competition with retail druggists. Rather, he said, Kaiser is in competition with other health service providers, such as Blue Cross, to gain members. Kaiser sees its pharmacies as merely one part of its total health care system. Raymond admitted, however, that since Kaiser's 286,342 members in the area are about 20% of the health care market, Kaiser also probably has about a 20% market share in prescription drug dispensing in its market area. Kaiser spent $18.7 million, or 7.3% of its total expenditures in 1985, on its pharmacy and optical program.

After years of fighting the issue of pricing differences, the druggists' association has also taken one recent action that could only be described as "if you can't beat them, join them." The association proposed a program, which the state has accepted, under which the state will purchase prescription drugs for welfare recipients. The state will distribute the drugs to the retail pharmacies which will dispense them at cost plus a slight service fee. The state estimates it will save almost $1 million a year with the program. The state, welfare recipients, and taxpayers will all benefit, while the only ones mad about the program are the drug companies, Hartman gloated.

The big retail drugstore chains can buy their drugs at better rates than independent stores because of volume purchasing power, Hartman admitted, but the price advantages don't begin to approach those of nonprofits. Chain stores have some competitive advantages over smaller stores, he said, but independents can meet that challenge by offering superior, personalized service and convenient neighborhood locations.

There used to be 300 independent pharmacies in the Portland area; now there are about 70. People seem to think it would create a "social disaster" if a not-for-profit hospital had to close, Hartman said, but an average of 2.5 independent pharmacies go out of business every day in the United States "and nobody seems to think about those jobs."

FIGHTING IN THE DIRT

Most people, upon meeting John Burnett, would find him very affable, the kind of guy who would be the life of a party or someone good to sit down and share a couple of beers with. But mention Burnett's name to some officials at Oregon State University, and the image that probably comes to their minds is that of Attila the Hun.

Burnett is president and owner of Chinook Research Laboratories of Lebanon, one of the two soil testing laboratories located west of the Cascades in Oregon. OSU operates the other one, and Burnett has been conducting a long-term one-man crusade against what he claims is illegal and unfair taxpayer subsidization of the commercial work performed by that lab.

A 1975 OSU graduate, Burnett started his lab in 1977. In the years since, he said there have been three other attempts by private individuals to start soil testing labs, but none of them succeeded because they "couldn't take the fierceness of the OSU competition."

In 1982, Burnett first secured a ruling from the State Board of Higher Education that the OSU soils testing lab had to figure overhead into its commercial rate structure.

Professor Benno Warkentin, head of OSU's Department of Soil Science which operates the lab, said if it hadn't been for Burnett's "persistence" the lab would never have been billed for overhead on its commercial work. Warkentin said he believes overhead charges are unfair since the commercial work is well within the university's duty to perform public service.

But Burnett says he made one mistake when he secured the 1982 ruling from the Board of Higher Education. "My mistake was that I didn't insist that the State Board order the lab to be *fair* when figuring expenses."

In the years since, Burnett contends that the lab has consistently underestimated its expenses. Up until last year, he said, the result was that the OSU lab was pricing its tests at times as much as 40% below the level of his lab. Last year, Burnett said he discovered that OSU, at least in the soils testing lab, was using accounting procedures for its federal grants which violated federal regulations by charging a higher level of overhead to federal grants than to commercial work. Burnett said he wrote federal agencies, requesting an audit of OSU's accounting procedures for federal grants. The audit was performed last September, Burnett said, and shortly thereafter the OSU lab raised its rates to levels generally comparable to his.

Warkentin denied that the federal audit had anything to do with the lab raising its rates. He said the 25% increase in rates came about because of the regular review the OSU lab makes of its operations every two years to make sure its rates reflect actual costs. The lab's commercial work is not subsidized, Warkentin said.

The professor added that the OSU lab enjoys high prestige and support in the state's agricultural community and that Burnett was the only person he knew who wanted the OSU lab to stop its commercial work.

pare his overhead on equal terms to commercial rates, one would have to include everything OSU charges him for, which means his rates are actually about $15 per square foot.

Burnett counters that it isn't often that "rent" includes bookkeeping and accounting and everything else included under administrative services. If Warkentin were really paying $15 a square foot just for rent in Corvallis, he should "be screaming that his rent is too high," Burnett added.

JOHN P. DAUGIRDA

SQUEEZING OUT COMPETITION? John Burnett claims Oregon State University's soil testing lab in Corvallis keeps private researchers like himself from working on some commercial projects in the Willamette Valley.

Despite OSU's price increase, however. Burnett still insists that OSU is now just pricing its commercial service to remain competitive, not to reflect true cost. As one example, he says the university is charging the lab just 1.8 cents a square foot for space, while the average rate in Corvallis for that type of space is closer to 50 cents a square foot. "You can't get space in Fossil, Oregon for that price," Burnett said. Also, the lab pays nothing for its phone service.

Overall, OSU records show the lab paid $15,344 for overhead for its commercial work in 1984-85. This includes rent, administrative costs, and janitorial service. Burnett: "There isn't a business I know of that wouldn't like to only have that amount each year in overhead. I would love to have that low an overhead." He employs nine people at his lab, which conducts about 5,000 soil sample tests a year and also does various other kinds of testing.

Warkentin said it was OSU's "odd form of accounting" which made it appear that rent was that low for the 1,000 square feet of the lab dedicated to commercial work. Actually he said, to com-

Burnett has never taken OSU to court. He says the courts take too long and legal fees cost too much. Also, he added, "once you take them to court they can sweep the issue under the rug and refuse to comment publicly on it." Likewise, Burnett doesn't feel it will do small business people much good to take the tax-exempt competition issue to the state legislature, because so many of its members are public employees. He believes their sympathies would generally be with the tax-exempt sector. For instance, the Joint Revenue and School Finance Committee, which will act first on any new definition of "charitable" organizations, is currently co-chaired by employees of a community college and a public school district.

Instead, Burnett has relied on access to public documents and has immersed himself in the budget and bookkeeping systems of the OSU lab.

"You can raise more havoc getting right down into their accounting procedures, rather than arguing philosophically with them about what they should or shouldn't be doing," Burnett said, adding, "but it isn't easy."

sacred cows in this town — the college and the Shakespearean Festival, and we are seen as taking them both on," said Leo Jensen, one of the motel owners. When school officials told students that dorm rates would have to be raised if the summer rentals weren't allowed, students picketed the motels conducting the suit. And school officials and students continue to boycott the motels, Jensen said, by advising visitors to stay in other motels. As a final point, Jensen said one of the small business owners dropped out of the suit after purchasing officials at the college student union threatened to stop buying bagels from him.

But Jensen and the other small business owners challenging their not-for-profit competition say they can put up with the problems that come with an image of "fighting the establishment." They just want the not-for-profit organizations who are competing directly against them to play under the same rules as for-profit firms.

Small Business Remedies

For his part, Eisenzimmer would like to see a six-part test applied to private nonprofit organizations to determine if they are eligible for tax exemption. That six-part test arose out of a 1985 decision by the Utah Supreme Court, which ruled that two previously not-for-profit hospitals no longer qualified for a property tax exemption. The six criteria are:

1. Whether the stated purpose of the entity is to provide service to others without immediate expectation of material reward;
2. Whether the entity is supported, and to what extent, by donations or gifts;
3. Whether the recipients of the "charity" are required to pay for the assistance received, in whole or in part;
4. Whether the income received from all sources produces a "profit" to the entity in the sense that the income exceeds operating and long-term maintenance expenses;
5. Whether the beneficiaries of the "charity" are restricted or unrestricted and, if restricted, whether the restriction bears a reasonable relationship to the entity's charitable objectives; and,
6. Whether dividends or some other forms of financial benefit are available to private interests and whether the entity is organized and operated so that any commercial activities are subordinate or incidental to charitable work.

If a test such as this were strictly applied to organizations before granting them tax exemptions, Eisenzimmer said, it would remove much of the abuse from the current system.

The business people who are most concerned about competing against publicly owned facilities operated by institutions such as colleges and universities see the need for different remedies. They would like strict limits or even prohibitions placed on how much commercial work such agencies can do and strict accounting standards enforced to make sure no taxpayer subsidization is taking place. They also advocate a dollar-for-dollar reduction in state funds for every dollar of commercial work.

Burnett and Czyzewski also say that professors should be prohibited from taking employment as independent consultants unless they are on sabbatical. They say many professors spend a good deal of time taking jobs as independent consultants and often end up competing against private businesses that offer the same service. Then the ones who really get shortchanged are the students who find their professors are too busy with outside business interests to carry a full teaching load. "If professors need to find out what the 'outside' world is like, let them take sabbaticals; that's what they're for," Burnett said. "The current system is 'garbage.' It cannot be justified."

"There are two sacred cows in this town — the college and the Shakespearean Festival, and we are seen as taking them both on," says Leo Jensen, a motel owner.

Eisenzimmer, Tosterud and some of the other people most concerned about "unfair" competition don't plan to stop with attacking the property tax exemption. They also want the nonprofits that they say are not really charities to be subjected to state and federal income taxes and to paying the same postal rates as for-profit businesses.

Nonprofit corporations are subject to federal taxes on their "unrelated business income" (UBI), which is income from activities not directly related to the reason for their tax exemption. For instance, if a nonprofit hospital operated a service station and made money at it, it would have to pay federal corporate income tax on the station's profits even though the proceeds might go to benefit the hospital. This is an obvious example, but there are many borderline cases — if a hospital's cafeteria is open to the public and the hospital gets a comparatively large amount of income from its cafeteria, that income could become subject to UBI tax, for instance. But the UBI tax does not appear to be onerously applied; all nonprofits combined only paid $50 million in UBI taxes in the United States in fiscal year 1984.

At the federal level, the small business people would favor steps advocated in the 1983 SBA report. These include placing a higher tax rate on unrelated business income, or prohibiting that income entirely for nonprofits; defining more clearly what constitutes unrelated activity; making the percentage of an organization's revenues coming from UBI a criterion for tax exemptions; figuring tax factors into all bids for federal contracts by private nonprofit organizations; and very strictly regulating commercial use of government agency or public university equipment.

Winning Is Outlasting Your Opponents

For their part, the business people engaged in these battles against nonprofit competition realize they face a long, tough battle. The Ashland motel owners just won the first round of their court fight some six years after SOSC started renting dorm rooms to tourists. Both sides expect the battle between the athletic clubs and the YMCA to eventually reach the Oregon Supreme Court, but to take at least three years to do so.

Hartman said the Portland druggists association has been fighting the unfair organizations since 1969 and has appeared before 110 federal judges in that time. (See story, page 21.) He said public sentiment is beginning to swing in support of the samll businessman, but he expects it to take another six or seven years to achieve a system that requires fair competition.

Czyzewski said he has been complaining about unfair competition by tax-exempt organizations for 40 years and thinks he may be seeing a change in public opinion. Meanwhile, he says, "I'm not going out of business. All I have to do is live long enough" to see his viewpoint prevail.

Meanwhile, no one should underestimate the determination of these business people. Burnett is a stocky man who laughs easily and often. And even though he laughs when offering his suggestions for how a small business can win out against large, nonprofit institutions, there is a certain steely edge to his voice that demands attention. Burnett says Eisenzimmer, after three years of fighting the YMCA, still seems emotional about the issue, and understandably so. Burnett said he was that way when he first started fighting the OSU soils testing lab in the late 1970s. Then, however, Burnett observed, "I learned that my anger and emotion were getting in the way of what I wanted to accomplish. What you have to do is coldly and methodically tear them to shreds. It's unfortunate because good things may get lost in the process. But you can't get their attention any other way." ■

COME WATCH US GROW!

SUBSIDY NEED:

It is the YMCA's philosophy to make services available to everyone regardless of his or her ability to pay. To meet scholarship and special community needs, the YMCA will accept an aggressive challenge for financial development:

	1984	2000
• *Current Support*	$ 300,000	$ 1.2 million
• *Endowment*	$ 1 million	$ 15 million
• *Special Project Funding*	$ 300,000	$ 750,000
• *Capital Funding*		$ 20 million

FUNDING & BUDGET GROWTH:

The YMCA of Columbia-Willamette is non-profit organization with 86 percent of its budget derived from membership and program fees. The remainder comes from people who believe in the YMCA and its mission, and the ability of the organization to be a responsible custodian of their funds.

In the YMCA's annual "Straight From The Heart" campaign, over 4,000 people give needed dollars to help programs continue in their communities. Generous bequests and deferred giving funds also are wisely invested by the YMCA to reap benefits which directly help people.

The YMCA is a member of United Way and receives nearly 8 percent of its total budget to meet that organization's emphasis to combat emerging needs in our communities.

BUDGET PROJECTIONS

	1984	1990	2000
Membership Dues, Program & Service Fees	$ 3,727,810	$10,156,290	$20,637,177
Contributions & Endowment Earnings	542,618	1,380,000	2,760,000
United Way	428,134	463,710	602,823
Total Revenue:	$ 4,698,562	$12,000,000	$24,000,000
Branch Operations	$ 4,370,045	$11,280,000	$22,560,000
Administration	276,601	720,000	1,440,000
Total Expenses:	$ 4,646,646	$12,000,000	$24,000,000

MEMBERSHIP GROWTH:

	1984	1990	2000
Different Members Served:	25,717	59,362	89,043
YOUTH	8,229	18,996	28,494
ADULTS	17,488	40,366	62,549
MALE	12,344	28,494	42,741
FEMALE	13,373	30,868	46,302
Current Support Members:	4,483	9,234	18,468
Different Participants Served:	32,731	63,188	104,892

FACILITY EXPANSION:

The YMCA is more than just a building—it's people serving people. Today, many YMCA programs operate in schools, churches and other community facilities, but we can serve people in more ways through more YMCA buildings.

In 1984, the YMCA owns three facilities:

- Southeast YMCA's Leach Center
- Northeast YMCA's Hollywood Center
- Camp Collins

In the next four years, we will add two new facilities:

- South Waterfront YMCA in downtown Portland
- Eastside Family YMCA near Gateway

Future plans currently underway for development by the year 2000 could include family YMCAs in west Clackamas County, Clark County, Washington County, southeast Clackamas County and Gresham.

THE
YMCA

We're with you
for a
lifetime.

CONCLUSIONS FROM EVIDENCE IN
ORE. DEPT. OF REVENUE TAX HEARING
YMCA OF COLUMBIA-WILLAMETTE

A. Lack of community support.

According to the testimony of Robert Hall, Chief Financial Officer, $83,000 of contributions were donated through Metro Fitness Center (MFC) in fiscal year ending 6/30/85. ($35,000 was assigned to MFC; $27,000 was assigned to Metro Community Center; $21,000 to other centers.) This $83,000 figure represents only 3.3% of the total revenues of MFC.

In 1975 and 1976 the YMCA-CW raised almost $2,000,000 to defray the cost of MFC. There was no evidence as to the identity of large contributors. In fiscal year 1980-1981 an $800,000 gift from the Leach Estate was applied toward the MFC mortgage balance. (Exh 46)

B. Source of operating revenues.

For fiscal year ending 6/30/85 revenues for MFC are as follows (Exh 5):

Source	Amount	% of Total
Contributions	$ 35,756	1.5
Membership Dues	1,858,983	76.1
Program Service Fees	498,229	20.3
Sales to Public	50,645	2.1
	$2,443,613	100.0

For fiscal year ending 6/30/86 revenues are as follows (Exh 42):

Source	Amount	% of Total
Contributions	$ 19,147	.7
Special Events	(178)	-
Membership Dues	1,869,718	77.6
Program Service Fees	471,522	19.6
Sales to Public	48,321	2.1
	$2,408,530	100.0

C. Profitability.

The profit and loss statement for MFC for fiscal year ending 6/30/85 (Exh 5) is condensed as follows:

Total Revenues	$2,443,613	
Less: Contributions	(35,756)	
Revenues from Operations		$2,407,857
Total Expenses (including principal payments on mortgage)	2,370,027	
Less: Interbranch transfer to Administration	(358,539)	
Less: Payments to National YMCA Organization	(39,825)	
Total Operating Expenses		1,971,363
Net profit from Operations		$ 436,494
Ratio of net profit to revenues		18.1%

Similarly, for fiscal year ended 6/30/86 (Exh 42):

Total Revenues	$2,408,530	
Less: Contributions	(19,147)	
Revenues from Operations		$2,389,383
Total Expenses	2,290,677	
Less: Interbranch transfer to Administration	(367,724)	
Less: Payments to National YMCA Organization	(34,591)	
Total Operating Expenses		1,888,362
Net profit from Operations		$ 501,021
Ratio of net profit to revenues		20.9%

D. Metro Fitness Center profits fund YMCA administration.

All YMCA branches contribute to the central administration of the YMCA-CW. Besides clerical staff, the administration consists of the following personnel:

Position	Currently Held By	Salary
Chief Executive Officer	Jim Chapel	$64,000
Director of Operations	James Leigh	50,000
Director of Development	Christa Larson	40,000
Chief Financial Officer	Robert Hall	37,000
Director of Communications	Leslie Haines	26,500

In the fiscal year ending 6/30/85 the twelve branches contributed $572,229 toward administration. The Metro Fitness Center contributed $358,539, or 63%.

E. YMCA-CW has few bad debts.

Membership fees are payable in advance or through automatic bank drafts on a monthly basis. For the fiscal year ended 6/30/85 the allowance for doubtful accounts shown on the audited financial statements (Exh J) was 2.8% of total accounts receivable for the total organization.

F. Benefits to officers.

The YMCA-CW's fringe benefit package for the administrative employees (not including payroll taxes) costs the equivalent of 22.3% of gross salaries. (Exh 5)

The Chief Executive Officer received a loan from YMCA-CW of about $60,000 to purchase his home.

G. Accumulation of assets.

The difference between the book value of YMCA-CW's assets and liabilities is about $4,000,000 (Exh 45). This net worth is primarily represented by real property and an investment portfolio. Investments total $1,000,000 including a restricted endowment of $767,508.

H. Ability to pay taxes.

The YMCA-CW's Chief Executive Officer testified that the organization could not continue in business if it had to pay taxes. It is apparent, however, that the YMCA-CW has enough net worth to refinance its assets to pay its property tax bill.

For the fiscal year ended 6/30/86 (Exh 42) the Metro Fitness Center generated a cash excess of $117,853 after making principal payments on its mortgage, after paying $34,591 toward the obligation to the national YMCA organization and after contributing $367,724 toward the central YMCA-CW administration.

EXHIBIT 5

CONDENSED STATEMENT OF REV & EXP
BRANCH TOTALL
11 METRO FITNESS CENTER
PERIOD ENDING JUNE 30, 1985

CUR MONTH ACTUAL	CUR MONTH BUDGET	CUR MONTH VARIANCE			BALANCE 1 YR AGO	Y-T-D ACTUAL	Y-T-D BUDGET	Y-T-D VARIANCE	BUDGET TOTALS
				REVENUE					
114	1.674	1.560-	4000	**CONTRIBUTIONS**	35,431	35,756	30,000	5,756	30,000
120,680	158,242	37,562-	6000	**MEMBERSHIP DUES**	1,689,150	1,858,983	1,905,777	46,794-	1,905,777
37,836	49,629	11,793-	6200	**PROGRAM SERVICE FEES**	532,020	498,229	597,832	99,603-	597,832
2,196	5,449	3,253-	6400	**SALES TO PUBLIC**	50,202	50,645	65,600	14,955-	65,600
160,825	214,994	54,169-		TOTAL REVENUE	2,306,803	2,443,613	2,599,209	155,596-	2,599,209
				EXPENSE					
62,718	67,444	4,726-	7000	**SALARIES**	718,979	748,059	806,007	57,948-	806,007
11,579	11,853	274-	7100	**EMPLOYEE BENEFITS**	75,094	135,677	141,309	5,632-	141,309
7,036	7,579	543-	7200	**PAYROLL TAXES**	74,210	82,714	90,317	7,603-	90,317
3,351	4,467	1,116-	8000	**PROF FEES/CONTRACTS**	69,556	53,232	51,617	1,615	51,617
14,491	12,097	2,394	8100	**SUPPLIES**	149,555	130,571	155,637	25,066-	155,637
2,589	1,729	860	8200	**TELEPHONE**	11,164	17,219	20,715	3,496-	20,715
2,061	687	1,374	8300	**POSTAGE**	8,528	12,289	8,654	3,635	8,654
76,124	63,121	13,003	8400	**OCCUPANCY**	235,559	684,586	777,693	93,107-	777,693
5,920	5,532	388	8500	**RENTAL&MNTC-EQUIPMENT**	15,460	44,793	66,156	21,363-	66,156
2,754	2,508	246	8600	**PRINTING*PUBLICATIONS**	18,599	14,198	24,280	10,082-	24,280
2,612	1,205	1,407	8700	**LOCAL TRAVEL**	9,507	16,027	16,497	470-	16,497
259	1,874	1,615-	8800	**CONF/CONV/MTG/TRAINING**	13,744	12,216	19,546	7,330-	19,546
	33	33-	9000	**ORGN. MEMBERSHIP COSTS**	174	409	1,350	941-	1,350
29,878	29,887	9-	9150	**INTERBRANCH/METRO**		358,539	358,539		358,539
3,319	3,327	8-	9500	**PYMTS TO NATL ORGANIZ**	31,631	39,825	39,825		39,825
			9900	**MAJOR PROPERTY & EQUIP**		19,672	30,500	10,828-	30,500
224,691	213,343	11,348		TOTAL EXPENSE	1,431,759	2,370,027	2,608,642	23[illegible]615-	2,608,642
63,865-	1,651	65,516-		SURPLUS/DEFICIT	875,043	73,586	9,433-	83,019	9,433-

EXHIBIT 42

YMCA OF COLUMBIA-WILLAMETTE
CONDENSED STATEMENT OF REV & EXP
BRANCH TOTALS
11 METRO FITNESS CENTER
PERIOD ENDING JUNE 30, 1986

CUR MONTH ACTUAL	CUR MONTH BUDGET	CUR MONTH VARIANCE			Y-T-D BAL 1 YR AGO	Y-T-D ACTUAL	Y-T-D BUDGET	Y-T-D VARIANCE	YE BUDGET TOTALS
				REVENUE					
2,674	1,669	1,005	4000	**CONTRIBUTIONS**	35,756	19,147	31,020	11,873-	31,020
	60	60-	4200	**SPECIAL EVENTS**		178-	500	678-	500
157,914	160,089	2,175-	6000	**MEMBERSHIP DUES**	1,058,983	1,869,718	2,007,812	138,094-	2,007,812
21,120	41,321	20,201-	6200	**PROGRAM SERVICE FEES**	498,229	471,522	609,701	138,179-	609,701
3,843	6,466	2,623-	6400	**SALES TO PUBLIC**	50,645	48,321	64,210	15,897-	64,218
185,551	209,605	24,054-		TOTAL REVENUE	2,143,613	2,408,530	2,713,251	304,721-	2,713,251
				EXPENSE					
69,157	70,928	1,772-	7000	**SALARIES**	748,059	797,192	852,077	54,885-	852,077
11,539	13,065	1,526-	7100	**EMPLOYEE BENEFITS**	135,677	143,448	156,833	13,385-	156,833
8,493	8,346	147	7200	**PAYROLL TAXES**	82,714	91,703	100,191	8,488-	100,191
2,378	2,375	3	8000	**PROF. FEES/CONTRACTS**	53,232	44,648	31,922	12,726	31,922
14,132	11,886	2,246	8100	**SUPPLIES**	130,571	114,002	151,155	37,153-	151,155
524	1,849	1,325-	8200	**TELEPHONE**	17,219	10,846	22,182	11,336-	22,182
2,226	1,467	759	8300	**POSTAGE**	12,289	11,914	14,995	3,081-	14,995
51,001	44,425	6,576	8400	**OCCUPANCY**	676,635	537,804	568,441	30,637-	568,441
4,748	7,603	2,855-	8500	**RENTAL&MNTC-EQUIPMENT**	52,744	73,256	90,587	17,331-	90,587
8,548	1,561	6,987	8600	**PRINTING*PUBLICATIONS**	14,198	30,430	18,662	11,768	18,662
679	1,223	544-	8700	**LOCAL TRAVEL**	16,027	14,081	14,791	710-	14,791
1,265	1,786	521-	8800	**CONF/CONV/MTG/TRAINING**	12,216	8,454	28,824	20,370-	28,824
30		30	8900	**ASSISTANCE TO INDIVID**		30		30	
			9000	**ORGN.MEMBERSHIP COSTS**	409	361	1,400	1,039-	1,400
30,544	30,705	161-	9150	**INTERBRANCH/METRO**	358,539	367,724	367,024	700	367,024
			9200	**ACTIVITY INSURANCE**		1,050		1,050	
	13,774	13,774-	9400	**CONTINGENCY**			165,292	165,292-	165,292
2,884	2,884		9600	**PYMTS TO NATL ORGANIZ**	39,825	34,591	34,591		34,591
2,407-	46,086	48,493-	9900	**MAJOR PROPERTY & EQUIP**	19,672	9,143	77,132	67,989-	77,132
205,742	259,964	54,222-		TOTAL EXPENSE	2,370,027	2,290,677	2,696,099	405,422-	2,696,099
20,191-	50,359-	30,167		EXCESS/DEFICIT	73,586	117,853	17,152	100,701	17,152

EXHIBIT 45

THE YOUNG MEN'S CHRISTIAN ASSOCIATION
OF COLUMBIA-WILLAMETTE

BALANCE SHEET

June 30, 1986

	Current Funds		Land, Building and Equipment Fund	Endowment Fund	Custody Fund	Total All Funds
	Unrestricted	Restricted				
ASSETS AND DEFERRED CHARGES						
Cash (Note 3)		$ 10,620	$ 55,204	$ 2,745	$ 3,150	$ 71,719
Investments-at cost (market value-$1,121,340)	$ 191,655	14,981		767,508	26,826	1,000,970
Accounts receivable (net of allowance for doubtful accounts of $19,028)	161,685		15,619			177,304
Pledges receivable (net of allowance for doubtful pledges of $16,570)	70,623		98,356			168,979
Inventories	55,264					55,264
Deferred charges:						
Camp and summer program expenses	94,073					94,073
Memberships	114,036					114,036
Other	39,520					39,520
Prepaid expenses	44,843		2,250			47,093
Land, buildings and improvements, furniture and equipment, net (Notes 4 and 5)			4,586,415			4,586,415
	$ 771,699	$ 25,601	$4,757,844	$ 770,253	$ 29,976	$6,355,373
LIABILITIES, DEFERRED REVENUES, AND FUND BALANCES (DEFICIT)						
Bank overdraft (Note 3)	$ 74,850					$ 74,850
Notes payable (Note 5)	380,000		$ 926,261			1,306,261
Obligations under capital leases (Note 6)			201,189			201,189
Accounts payable	35,903		40,595			76,498
Accrued liabilities	84,297		1,074			85,371
Custody Fund liability (Note 7)					$ 29,976	29,976
Deferred revenues:						
Memberships	221,048					221,048
Camp and summer program revenues	130,683					130,683
Current support campaign contributions	250,070					250,070
Total liabilities and deferred revenues	1,176,851		1,169,119		29,976	2,375,946
Commitments and litigation (Notes 11 and 12)						
Fund balances (deficit):						
Current-unrestricted	(405,152)					(405,152)
Current-restricted		25,601				25,601
Land, building and equipment (Note 8)			3,588,725			3,588,725
Endowment (Note 9)				770,253		770,253
Total fund balances (deficit)	(405,152)	25,601	3,588,725	770,253		3,979,427
	$ 771,699	$ 25,601	$4,757,844	$ 770,253	$ 29,976	$6,355,373

ROUGH DRAFT

The accompanying notes are an integral
part of the financial statements.

THE YOUNG MEN'S CHRISTIAN ASSOCIATION
OF COLUMBIA-WILLAMETTE

STATEMENT OF SUPPORT, REVENUE, AND EXPENSES

for the year ended June 30, 1986

	Current Funds		Land Building and Equipment Fund	Endowment Fund	Total All Funds
	Unrestricted	Restricted			
Public support and revenue:					
Public support:					
Contributions	$ 385,692	$ 14,025	$ 587,284		$ 987,001
United Way	407,189				407,189
Total public support	792,881	14,025	587,284		1,394,190
Revenue:					
Government fees and grants	385,713				385,713
Membership dues	2,265,290				2,265,290
Program service fees	1,542,766				1,542,766
Sale of merchandise	127,262		2,099		129,361
Investment income	93,463	161		$ 54,439	148,063
Total revenue	4,414,494	161	2,099	54,439	4,471,193
Total public support and revenue	5,207,375	14,186	589,383	54,439	5,865,383
Expenses:					
Program services:					
Aquatics	327,781		80,472		408,253
Camping	372,971		13,135		386,106
Family life	873,882				873,882
Health enhancement	1,903,596	360	424,290		2,328,246
Leadership development	514,058		6,567		520,625
Youth sports and recreation	263,264				263,264
Total program services	4,255,552	360	524,464		4,780,376
Supporting services:					
Management and general	731,787		76,107		807,894
Fund raising			76,382		76,382
Total supporting services	731,787		152,489		884,276
Total expenses	4,987,339	360	676,953		5,664,652
Excess (deficiency) of public support and revenue over expenses	$ 220,036	$ 13,826	$(87,570)	$ 54,439	$ 200,731

ROUGH DRAFT

The accompanying notes are an integral part of the financial statements.

THE YOUNG MEN'S CHRISTIAN ASSOCIATION
OF COLUMBIA-WILLAMETTE

STATEMENT OF CHANGES IN FUND BALANCES (DEFICIT)

for the year ended June 30, 1986

	Current Funds		Land Building and Equipment Fund	Endowment Fund	Total All Funds
	Unrestricted	Restricted			
Fund balances (deficit), July 1, 1985	$(225,811)	$ 11,775	$3,276,918	$ 715,814	$3,778,696
Excess (deficiency) of public support and and revenue over expenses	220,036	13,826	(87,570)	54,439	200,731
Interfund transfers:					
Notes and capital lease interest and principal payments	(219,332)		219,332		
Capitalized building improvements and equipment purchases	(180,045)		180,045		
Fund balances (deficit), June 30, 1986	$(405,152)	$ 25,601	$3,588,725	$ 770,253	$3,979,427

ROUGH DRAFT

The accompanying notes are an integral
part of the financial statements.

THE YOUNG MEN'S CHRISTIAN ASSOCIATION
OF COLUMBIA-WILLAMETTE

STATEMENT OF FUNCTIONAL EXPENSES

for the year ended June 30, 1986

	Program Services							Supporting Services			
	Aquatics	Camping	Family Life	Health Enhancement	Leadership Devel-opment	Youth Sports and Recreation	Total Program Services	Management and General	Fund Raising	Total Supporting Services	Total Expenses
Salaries	$187,526	$157,656	$452,482	$ 948,694	$317,171	$121,597	$2,185,126	$330,172	$ 18,918	$349,090	$2,534,216
Employee benefits	26,449	20,555	66,490	178,309	56,866	20,031	368,700	69,438	4,171	73,609	442,309
Payroll taxes	21,931	20,117	52,871	109,364	36,718	15,106	256,107	37,112	2,002	39,114	295,221
Total salaries and related expenses	235,906	198,328	571,843	1,236,367	410,755	156,734	2,809,933	436,722	25,091	461,813	3,271,746
Professional fees and contracts	1,339	19,602	8,491	72,007	2,485	16,355	120,279	80,381	19,923	100,304	220,583
Supplies	7,397	65,965	73,140	130,960	18,575	31,470	327,507	24,036	2,401	26,437	353,944
Telephone	2,950	5,335	15,991	17,838	11,623	4,745	58,482	10,288	960	11,248	69,730
Postage	939	2,658	7,301	20,106	3,985	2,647	37,636	8,683		8,683	46,319
Occupancy	68,047	41,386	101,909	324,412	25,421	26,147	587,322	76,327		76,327	663,649
Rental and maintenance of equipment	770	11,129	11,851	56,633	3,965	4,465	88,813	13,291	4,234	17,525	106,338
Printing and publications	1,933	5,407	16,414	35,909	5,477	9,971	75,111	20,363	11,846	32,209	107,320
Local travel	2,004	15,417	47,103	19,039	10,763	3,428	97,754	29,104	1,905	31,009	128,763
Conferences, meetings and training	3,173	1,907	8,312	14,283	12,844	3,302	43,821	23,878	245	24,123	67,944
Assistance to individuals	248		192	613	2,380	208	3,641				3,641
Organizational membership costs	130	853	324	576	257	156	2,296	4,921		4,921	7,217
Awards, grants and scholarships					1,507		1,507				1,507
Interest	1,662			157,804			159,466	7,502		7,502	166,968
Activity insurance		1,509	3,474	997	19	5	6,004	3,293		3,293	9,297
National dues	2,945	2,403	7,537	39,095	4,002	3,631	59,613	500		500	60,113
Miscellaneous		1,072		4,583			5,655	35,767	9,777	45,544	51,199
Total expenses before depreciation and amortization	329,443	372,971	873,882	2,131,222	514,058	263,264	4,484,840	775,056	76,382	851,438	5,336,278
Depreciation and amortization expense	78,810	13,135		197,024	6,567		295,536	32,838		32,838	328,374
Total expenses	$408,253	$386,106	$873,882	$2,328,246	$520,625	$263,264	$4,780,376	$807,834	$ 76,382	$884,276	$5,664,652

ROUGH DRAFT

The accompanying notes are an integral
part of the financial statements.

0032r

OREGON DEPARTMENT
OF REVENUE

ADMINISTRATIVE RULE REVIEW

[✓ NEW RULE]
AMENDED RULE
REPEALED RULE

[✓ PERMANENT RULE]
TEMPORARY RULE
TEMPORARY RULE BEING GIVEN PERMANENT STATUS

RULE NO OAR 150- 307.130-(A)	
PAGE 1 of 2	DATE December 16, 1986
NOTICE OF INTENDED ACTION	
BULLETIN BOARD October 1, 1986	HEARING SCHEDULED November 20, 1986

PURPOSE: To provide county assessors with a procedure to use in reviewing and determining qualifications for exemption.

Review Required in Determining Exempt Status of Property for Charitable Institutions

150-307.130-(A)

(1) The following criteria shall be used in determining the qualification for property tax exemption under ORS 307.130 when an application is made by a charitable organization as required in ORS 307.162, 307.112, or 307.166:

(a) Applicant must be an incorporated charitable institution. If application is made under ORS 307.162 the organization must be the owner or purchaser of the property. If application is made under ORS 307.112 the organization must be the lessee. If application is made under ORS 307.166 the organization must be the lessee or entity in possession.

(b) The activity conducted by the incorporated charitable institution must be for the direct good or benefit of the public. Public benefits must be the primary purpose rather than a by-product. Self serving organizations that benefit a small group or class of persons do not qualify as a direct charity.

(c) An important consideration shall be whether the activity of the incorporated charitable institution in some way lessens the normal burdens of government.

(d) A degree of gift or giving must be present in the activity conducted by the organization. If no gift is involved, there is no charity.

(e) The property shall be actually used or occupied for the benevolent and charitable work carried on by the organization.

(f) The use of the property must be consistent with the charitable purpose

0032r

OREGON DEPARTMENT
OF REVENUE

ADMINISTRATIVE RULE REVIEW

RULE NO. OAR 150- 307.130-(A)			
PAGE 2 of 2	DATE December 16, 1986		
NOTICE OF INTENDED ACTION			
BULLETIN BOARD October 1, 1986	HEARING SCHEDULED November 20, 1986		

X NEW RULE
___ AMENDED RULE
___ REPEALED RULE

X PERMANENT RULE
___ TEMPORARY RULE
___ TEMPORARY RULE BEING GIVEN PERMANENT STATUS

PURPOSE: To provide county assessors with a procedure to use in reviewing and determining qualifications for exemption.

---

and goal of the organization.

(g) There must be an actual charitable use of the property rather than just a charitable use of the income derived from the operation of the property. "Destination of income" theory does not qualify for exemption.

(h) The organization's articles of incorporation must require that its assets be used for charitable purposes when the organization dissolves.

(2) If an organization's primary source of funding is from a government entity, and the organization merely administers those funds, the organization does not qualify for a property tax exemption as a charitable institution.

(3) Recognition by the Internal Revenue Service of an organization as nonprofit and income tax exempt is not determinative of that organization's status for property tax exemption in Oregon.

(4) Only the portion of a property used for literary, benevolent, charitable or scientific purposes shall be granted exemption from ad valorem taxation under this provision. Property may be in part taxable and exempt.

Hist: Filed 9/22/86, Eff. 12/31/86

EXPLANATION OF HOUSE BILL 3018

As has been widely reported, the Multnomah County Tax Assessor cancelled the property tax exemption of the YMCA of the Columbia Willamette (YMCA-CW). The action followed a legal challenge brought by the Northwest Alliance for Market Equality (N.A.M.E.), an association of tax-paying health and fitness clubs. The assessor's action caused other nonprofit organizations to worry that they too might lose their property tax exemptions.

While the YMCA-CW was appealing to the Oregon Department of Revenue the determination of the Multnomah County Tax Assessor, the Department of Revenue itself formulated a rule to provide county tax assessors with guidance in reviewing qualifications for exemption. The rule contains several criteria, summarized as follows:

1. The organization must be an incorporated charitable institution.

2. The activity conducted by the organization must be for the direct good or benefit of the public. Public benefits must be the primary purpose rather than a byproduct. Self-serving organizations that benefit a small group or class of persons do not qualify as a direct charity.

3. An important consideration shall be whether the activity of the organization in some way lessens the normal burdens of government.

4. A degree of gift or giving must be present.

5. The property shall be actually used or occupied for the charitable work carried on by the organization.

6. The use of the property must be consistent with the charitable purpose and goal of the organization.

7. There must be an actual charitable use of the property rather than just a charitable use of the income derived from the property.

8. The organization's Articles of Incorporation must require that its assets be used for charitable purposes when the organization dissolves.

9. If an organization's primary source of funding is from a government entity and the organization merely administers those funds, the organization does not qualify for a property tax exemption.

In response to the actions of the Multnomah County Tax Assessor and the Department of Revenue Rule, the YMCA-CW and other nonprofit organizations formed a "coalition" to lobby for changes in the tax exemption laws. The coalition proposed a bill which would have broadened the types of organizations and activities which would qualify for property tax exemptions. Instead of accepting the coalition's bill, the House Revenue and School Finance Committee studied the issue, the Department of Revenue Rule and the current state of the law. The committee's work resulted in House Bill 3018, which accomplished two things.

First, the bill changed one element of the Department of Revenue Rule and now an organization will not be deprived of an exemption solely because its primary source of funding is from one or more governmental entities. Secondly, an organization shall not be deprived of an exemption because its purpose or the use of its property is not limited to "relieving pain, alleviating disease or removing constraints." This portion of the bill is a reaction to a recent court case. The legislature felt that the court case too narrowly defined charity.

Other than these changes, the legislature left the Department of Revenue Rule intact. This means that the YMCA-CW will not be entitled to an exemption if it is a "self-serving organization that benefits a small group or class of persons." The YMCA-CW must also demonstrate a degree of gift or giving. An "important consideration" shall be whether the activities of the YMCA-CW, in particular the operation of the Metro Fitness Center, lessen the normal burdens of government.

House Bill 3018 also included a provision that if a tax assessor disqualified an organization's tax exemption, the property shall be added to the assessment roll for the current tax year but not for the five previous years, as the law formerly required. It appears this may relieve the YMCA-CW of its burden for unpaid back taxes.

SCOTT MAGUIRE
The Outlook staff

he Gresham City Council voted 6-1 pay an overdue bill Tuesday night en though there was no contract igating the city.

resham will pay $5,395 to Enotech Operating Services to cover e cost of having water samples tested Gresham's sewer treatment plant oratory. The bill was first issued to e city in January 1982, said Bill meron, city engineer. The money vers water tests for about three ars.

In voting yes, councilors Mary pray-Peterson and Charles Becker lded comments.

"Reluctantly and disgustingly yes," id Becker.

"Not happily, I vote yes," said Opray-Peterson.

Councilor Al Hutchens just voted no.

Becker and Hutchens were the most outspoken in not wanting to pay the bill. They suggested that since the previous city manager didn't put it in writing the city wasn't obligated to pay. The agreement was apparently a verbal arrangement to pay Envirotech for the water tests.

At one point Becker even suggested legal action to recover the money from the previous city manager, Burke Raymond. However, Tom Sponslor, city attorney, told the council that a court would hold the city responsible for the bill. He also said the city didn't have a solid case against the former manager because he was acting in good faith and he didn't benefit from the arrangement.

Several of the councilors were disgruntled that the city manager could bind the city verbally. Councilor Tom Griffith wanted to form a resolution requiring that all contracts be brought before the council.

But, the city already has such a policy that was enacted on Aug. 3, 1982, which is after the water testing agreement, Sponslor said.

The council strayed from the topic of the city's obligation to pay a bill to the issue of dissatifaction with Envirotech.

"To my way of thinking, this is just another ambiguity in the contract with EOS," said Opray-Peterson. "We have alerted the company that we are looking at them."

Becker reminded the council that it had decided to not automati the sewer operations when i February 1985.

The council will begin re contract in a June special explain the agreement to councilors, said Mayor Mar

In other business:

- The council agreed to to provide funds to finish transportation in Greshan area. Under the Transit St Planning Program, and the agreement for the Light R Tri-Met has committed it study.

Such a study was stoppe 1982 because of "lack of dir cording to a letter from th Planning Commission.

- The council presented

Mar. 4th-83

Gresham throws out welcome mat for new YMCA programs

y SCOTT MAGUIRE
f The Outlook staff

Gresham has invited the MCA to move in.

YMCA programs have een involving some East County and Gresham kids or three years. But, Mayor Margaret Weil has invited he "Y" to bring its full-scale programs and perhaps a recreation center to town.

Weil also has offered to let the YMCA build on city property. The possible site will be near City Hall, she said. It is a "good location" with access to the future light-rail station and to the Gresham school district offices, the mayor said.

"Our board is extremely excited in reaching out into the Gresham area, said Jim Chapel, president of the YMCA of Columbia-Willamette. Two studies are presently under way in Gresham, he said.

His organization is conducting a strategic planning study in Gresham to determine what programs would best meet the recreation needs of the area. The study will take six to eight weeks, and will allow the YMCA to have programs rolling in the city by June.

"We have authorized bringing a senior staff person and a half-time program director to Gresham this summer," he said. "We will work with existing organizations — churches, Mt. Hood Community College — to provide youth activities. We will also have an office in Gresham by summer with a phone for people to register for programs."

The YMCA will offer youth programs including youth sports, camping, day camp activities and special events.

The second study is a capital development planning process. The financial study will take several months, and the results will determine whether a center could be built here. The YMCA will consider Weil's offer of city property in the study, Chapel said.

Weil submitted a list of 25 key community leaders to the YMCA. These people will be interviewed to determine the ability of the community to support a center financially, as well as the potential for volunteer help to run the programs, Chapel said.

"My vision is to have a cradle to grave program, and the YMCA can fill that need," said Weil. "I see a real need for recreational community programs."

Gresham's community schools, which have children out of school at varying times throughout the year, presents a special challenge to the YMCA, Weil said.

Weil heard in February that the Y was expanding its operation in the Gateway area. At that time she met with Chapel, and began the effort to attract the YMCA to Gresham.

Two acts

Two major acts have joined the line-up for the second annual Mt. Hood Festival of Jazz.

Keyboard artist Herbie Hancock will be one of the featured headliners in the opening concert on Aug. 6 in the Mt. Hood Community College stadium.

He will be joined by V.S.O.P. It features rising jazz star and Hancock-protege Winton Marcellus, who has two albums due for simultaneous release in June; Ron Carter and Tony Will.

The Winton Marcellus Quintent is scheduled for the second concert on Aug. 7.

This year's festival features two day-long concerts, starting at 1 p.m. and ending about 11:30 p.m.

Ticket sales are doing well, said festival manager Bob Dematteis.

Last year's series ticket holders received first ch: ye: da re De m sor or

Classified:
667-6633

MEMORIAL
KINDERGARTEN
and
PRE-KINDERGARTEN
4100 SE 182
Classes for 3, 4 and 5 year old. Registering now for September, 1983. Limited enroll-

YAMAHA MUSIC CENTER
SPRING HOUSE CLEANING
SALE
Save on New Console & Studio Upright Pianos

CM-1

TELL
YMCA
IS NOT A
CHARITY

Staff photo by Terry Farris

Frank Eisenzimmer, second from left, and Don McIntire, right, participate in demonstration Tuesday at YMCA's Riverplace facility.

YMCA protest

Gresham athletic club owners help lead demonstration

by DAVE PINSON
of The Outlook staff

Braving cold wind and slashing rain, supporters of the Northwest Alliance for Market Equality protested on Tuesday the opening of the Riverplace YMCA in downtown Portland

The group which is headed by Gresham athletic club owner Frank Eisenzimmer claims the new facility on the Willamette River will compete with private business Eisenzimmer, owner of Cascade Athletic Club, and Don McIntire, owner of McIntire's Athletic Club in Gresham, joined 80 other sign-carrying demonstrators in their rain gear for the protest

"It makes us look a little more dedicated," Eisenzimmer, who is chairman of the NAME group, said of the steady downpour

Protester Steve Sackmann of Corvallis said he was participating because the YMCA enjoys tax-exempt status

"If the YMCA doesn't have to pay taxes, then private industry shouldn't have to pay taxes," Sackmann said

The demonstration was part of NAME's efforts to have the YMCA pay taxes on physical fitness services, Eisenzimmer said

Eisenzimmer's group plans to present legislation in Oregon during the next session of the Legislature The bill would call for the state to tax any portion of non-profit group's business devoted to physical fitness, Eisenzimmer said

Under the bill, he said Tuesday in Portland, the YMCA "won't be able to have the Yuppies come down here and lift weights and be subsidized by taxes "

'If the YMCA doesn't have to pay taxes, then private industry shouldn't have to pay.'
— Protester Steve Sackmann

But Jim Chapel, president of the YMCA of Columbia-Willamette, said the Riverplace YMCA center was not built next to the trendy Riverplace condominium complex to cater to affluent Portlanders

The YMCA is leasing the building from Cornerstone Columbia Co , Chapel said The YMCA thoroughly examined the issue of opening the center, he said It finally did so for many reasons, including the opportunity to increase service to adult members and to provide youth water programs on the Willamette River

Some 47 percent of the membership of the recently opened center is made up of families, Chapel said There are nearly 700 members, and the YMCA is shooting for a membership of 2,400 to 3,000, Chapel said

The YMCA earns its tax exemption every day through its programs in the community, he said

The YMCA is appealing a Multnomah County tax assessor's ruling that the organization is not a non-profit group. That decision opened the door for the YMCA to be assessed for local property taxes A ruling on the appeal is expected from the Oregon Department of Revenue in October, Chapel said.

The YMCA and other non-profit organizations

Turn to PROTEST, Page 4A.

Protest

Continued from Page 1A.

will present legislation themselves seeking a final definition of tax-exempt organizations, Chapel said

As for the demostrators, Chapel said he wished they would visit the building without their signs and take a tour to see what kind of programs the YMCA provides to the community

In fact, Chapel said he would like to see the opposing groups find some middle ground on the issue

"I really would hope that somewhere down the line that we could get together and see what we can do to help the community," he said

The worst-case scenerio for the YMCA, Chapel said, would be to lose the tax-exempt appeal

"We're talking about a couple of million dollars That would bankrupt the Y and have a devastating impact on other non-profit organizations," he said

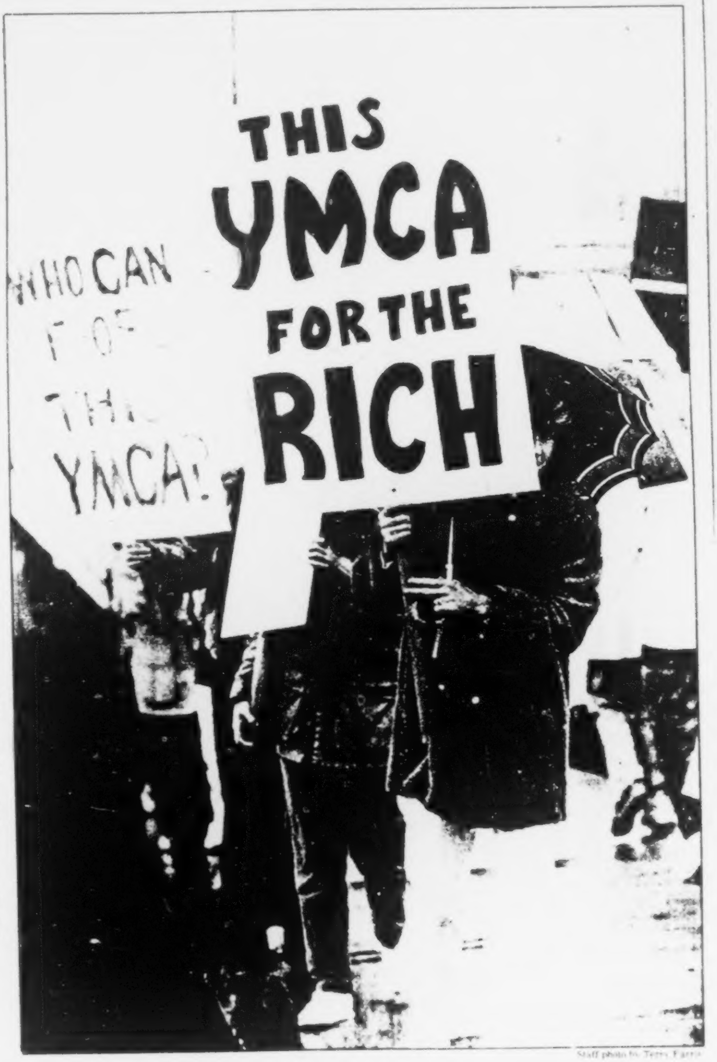
NAME is not criticizing the whole YMCA program, Eisenzimmer said

Community and youth programs are fine, he said, but he wants the local taxation of the physical fitness programs to stick

Eisenzimmer's group is backed by the International Racquet Sports Association, an organization representing more that 1,200 athletic clubs across the United States

Athletic clubs across the country are doing as much community program work as the YMCAs are, Eisenzimmer said

The demostration ended after about 45 minutes because of the bad weather


THIS YMCA FOR THE RICH
WHO CAN
YMCA?

Staff photo by Terry Farris

Demonstrators claimed that the new facility on the Willamette River will cater to affluent Portland residents.

Mr. DORGAN. The time of the gentleman has expired. The next speaker will be Spencer Garrett, president of Pierpoint Racquet Club, Ventura, Calif. Mr. Garrett, the committee welcomes you and will be glad to include your entire testimony as part of the record. We would request you summarize.

STATEMENT OF SPENCER GARRETT, PRESIDENT, PIERPOINT RACQUET CLUB, VENTURA, CALIF., ON BEHALF OF THE INTERNATIONAL RACQUET SPORTS ASSOCIATION

Mr. GARRETT. Thank you. I would like to start off with an experience that I had this morning. I went over to the YMCA in downtown here, and told them that I was in town for a couple of days and was interested in finding out about using the facility. They asked me if I was a member of a YMCA anywhere and I said no. They said well, you cannot use the facility unless you are a member of some other YMCA or if you are the guest of a member of this YMCA. I asked if I could look around the facility and they said no, you will have to come back when we have someone to give you a tour. This is not exactly my idea of a charity. I was able to see the swimming pool that they have through the windows on the side. It is a very nice swimming pool. It was probably paid for by tax deductible contributions. It probably cost more than my club cost in Ventura, Calif.

The charities are very important. As a member of the Ventura Boys and Girls Club Board and the past president, I am active in their fundraising attempts and we are always looking at more money to fund services. I am on the executive committee of United Way of Ventura County. We have a real problem. We cannot raise enough money to provide for the needs of the county. So charities need to be served but I do not believe that it is fair that charities can compete against businesses and have significant advantages. To me, the rationale was often confusing. Shortly after we opened up our club in Ventura, I went to work for a racquetball and fitness facility in Ventura, as their general manager in charge of their three clubs. In the 2½ years that I worked for them, we expanded from three to eight clubs. Shortly after I quit, they started getting out of the business. They sold those eight facilities. Of those original eight, two of them are now other uses, two of them are privately operated, and four of them are YMCA's.

The YMCA in Ventura, where my headquarters were and which I am very familiar, use what I operated as the general manager, was paying property taxes. The YMCA took over the building, put the name YMCA on the side of it, and all of a sudden, they did not have to pay property taxes. They did not change their operations at all. All they did was change their name and they became tax exempt because it is in writing. The YMCA's in Ventura decided to expand so they could generate more revenue. They went to the school district and asked them for some free land so they could build their swimming pool right next to their existing club. To their surprise, we were there to object. The school board put it on hold. We met with the YMCA and expressed our concern. They were surprised that anyone could object to this and they mentioned, well, we are planning to do this in Thousand Oaks, Oxnard, Camarillo, Samil, all of the cities around us. This was their plan, to build more and more clubs. So I asked them, I said, well, when you build this swimming pool with the money you are going to raise which is tax free, can I bring down a bus load of kids to go swimming at 5 in the afternoon from the Boys and Girls Club? And the fellow looked at me and he says, you know you cannot run a business that way.

And that I see is the problem. The YMCA wants the best of both worlds. They want to be able to run a business and they want to be a charity. I do not feel that it is fair that I should be subsidizing my competition. They do not pay property taxes, I do. I am subsidizing their operations and yet they compete against me. If, like the Y, I could raise $1 million through tax deductible contributions, and if I did not have to pay property taxes, I could lower my dues 25 percent. Save my members 25 percent and still make more money. People are waking up to this.

A colleague of mine says I do not think the YMCA is a competitor of mine. We have free weights, they do not. Well, the YMCA does now have free weights. I think you have a copy of some ads that I gave you. I have in there ads from 18 months ago. You look at these ads and say, umph, three different ads for fitness clubs. Turn to the next page and you will find out oh, yeah, one of them is a YMCA. The ads are indistinguishable. Now their ads have changed since we questioned them. Now, at the bottom, they say we are a nonprofit organization doing these other things. But they are still out there competing, advertising their prices, and I know of two other operators who are in direct price competition with the Y, they lower their prices, the Y lowers their prices.

Who benefits from the YMCA? In 1985, the top five individuals for the Santa Barbara YMCA received salaries from $46,500 to $59,000, not counting business expenses and benefits. That is a lot more money than I make. It is a lot more money than the average IRSA club manager makes for their multi-use facilities, their most prominent facilities. Who really benefits? My brother and I have decided there is a way around this. We are going to become a charity. We keep talking about, well, why don't we sell our business to the Ventura Boys and Girls Club, take out a long note, sell it for a real nice profit, give them 8 or 9 percent interest on the note, pay it off over 20 years. They will not have to pay property taxes. They can raise money and make more improvements so that they can attract more and more members. They can benefit from lower postage and other advantages. We can take back a management contract and charge a lot higher salaries. We would be a lot better off and the Ventura Boys and Girls Club, if we just gave them the savings on our property tax, they would be $20,000 better off.

Society needs charities but they need these charities to be responsible. I noticed today, when I went to the YMCA, that there was a sign down below in big, bold letters that said, no lodging. YMCA's used to be synonymous with lodging. But they do not allow lodging at this YMCA. We have a problem today. We have homeless people; we have hungry people. We have people that do not have a place to shower. I may be a little idealistic, and the YMCA would say that I am unrealistic, but if the YMCA were to open up their facility here and let some of these people take showers, people that need showers, and if at night they rolled some beds into the racquetball courts and we had racquetball cots and not racquetball courts, it would be a lot more benefit in today's society. Thank you.

Mr. DORGAN. The time of the gentleman has expired. Thank you very much for your testimony. Before I recognize members of the subcommittee, let me note that Mr. Ford from Tennessee is unable to be with the subcommittee today but has asked that his statement, along with questions for this panel, be included in the record.

[The statement of Mr. Ford and questions submitted to witnesses follow:]

HAROLD E. FORD
9th District, Tennessee

COMMITTEES:
WAYS AND MEANS

CHAIRMAN
Subcommittee on Public Assistance
and Unemployment Compensation

DEMOCRATIC STEERING AND
POLICY COMMITTEE

SELECT COMMITTEE ON AGING

2305 Rayburn House Office Building
Washington, DC 20515
(202) 225-3265

Congress of the United States
House of Representatives
Washington, DC 20515

MEMPHIS OFFICES:

167 North Main Street
Federal Office Building, Suite 369
(901) 521-4131

193 West Mitchell Road
(901) 521-4141

A.J. COOPER
Administrative Assistant

JOHN MURDOCK
Legislative Director

June 26, 1987

The Honorable J. J. Pickle
Chairman
Ways and Means Subcommittee
on Oversight
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I am required to be in my District on Monday, June 29, 1987, and therefore, will be unable to attend the Subcommittee Hearing on the Unrelated Business Income Tax.

I have enclosed an opening statement and a set of questions for both YMCA and Commercial Health Club witnesses, along with three attachments. I would appreciate it if you would have the enclosed statement, questions, and attachments made a part of the record of the Hearing. I would appreciate it, if you would ask the witnesses to respond to the questions, in writing, for the record.

Also, I want to applaud your leadership on this issue. I regret that I have not been able to personally spend more time at the Hearings, but as you know, I have been occupied otherwise.

Sincerely,

Harold

HAROLD FORD
Member of Congress

HF/blg

HAROLD E. FORD
9TH DISTRICT, TENNESSEE

COMMITTEES:
WAYS AND MEANS

CHAIRMAN
SUBCOMMITTEE ON PUBLIC ASSISTANCE
AND UNEMPLOYMENT COMPENSATION

DEMOCRATIC STEERING AND
POLICY COMMITTEE

SELECT COMMITTEE ON AGING

2305 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-3265

Congress of the United States
House of Representatives
Washington, DC 20515

MEMPHIS OFFICES:

167 NORTH MAIN STREET
FEDERAL OFFICE BUILDING, SUITE 369
(901) 521-4131

183 WEST MITCHELL ROAD
(901) 521-4141

A.J. COOPER
ADMINISTRATIVE ASSISTANT

JOHN MURDOCK
LEGISLATIVE DIRECTOR

June 29, 1987

STATEMENT BY REPRESENTATIVE HAROLD E. FORD

at the

SUBCOMMITTEE ON OVERSIGHT HEARINGS ON THE

UNRELATED BUSINESS INCOME TAX

I am proud to have served for a number of years as a member of the Board of the Memphis-Shelby County YMCA. I have seen first hand the many ways in which the YMCA is serving the youth and adults of Memphis. Let me mention just a few examples: A year ago the YMCA reopened a 28,000 square foot center to serve inter-city youth; the Memphis YMCA operates successful pre-employment and job training programs for junior high and high school youth; it sponsors a Black Achievers program that gives successful role models to black high school students; it conducts a rehabilitation program for juvenile offenders, and it provides teen pregnancy and parenting counseling. The list could go on.

For decades, the Memphis YMCA has also provided fitness programs to the youth and adults of Memphis--programs that have significantly enhanced the quality of life for thousands in our community. These programs are a direct expression of the YMCA's charitable mission of building healthy bodies, minds, and spirits. The fitness programs also draw into the YMCA many adults who go on to become volunteer leaders and financial supporters. In short, the fitness programs are integrally related to the YMCA's charitable mission and significantly strengthen the YMCA's ability to provide other much-needed community services.

In my view, the YMCA's fitness programs do not become any less of a community service--any less charitable--just because an entrepreneur opens a commercial health club in the same community. The commercial health club industry has been plagued by widespread consumer complaints and frequent bankruptcies. Given these facts, I do not think we can or should rely on commercial health clubs to meet the community fitness needs traditionally served by YMCAs.

YMCAs have earned their tax-exemption through more than a century of dedicated community service. I see no compelling reason to question their tax-exemption today.

J.J. PICKLE, TEXAS, CHAIRMAN
SUBCOMMITTEE ON OVERSIGHT

BERYL ANTHONY, JR., ARKANSAS
RONNIE G. FLIPPO, ALABAMA
BYRON L. DORGAN, NORTH DAKOTA
HAROLD FORD, TENNESSEE
CHARLES B. RANGEL, NEW YORK
ANDY JACOBS, JR., INDIANA

DICK SCHULZE, PENNSYLVANIA
BILL FRENZEL, MINNESOTA
WILLIAM M. THOMAS, CALIFORNIA
RAYMOND J. McGRATH, NEW YORK

Ex Officio:
DAN ROSTENKOWSKI, ILLINOIS
JOHN J. DUNCAN, TENNESSEE

Subcommittee on Oversight
Reading Copy

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515

SUBCOMMITTEE ON OVERSIGHT

DAN ROSTENKOWSKI, ILLINOIS, CHAIRMAN
COMMITTEE ON WAYS AND MEANS

ROBERT J. LEONARD, CHIEF COUNSEL
M. KENNETH BOWLER, STAFF DIRECTOR
BETH KUNTZ VANCE, SUBCOMMITTEE STAFF DIRECTOR

A.L. SINGLETON, MINORITY CHIEF OF STAFF
MICHAEL A. SUPERATA, COUNSEL TO THE MINORITY

FULL COMMITTEE HAS COPY
29th

July 27, 1987

Mr. Solon Cousins
Executive Director
YMCA of the USA
1030 15th Street, N. W.
  Suite 976
Washington, D. C. 20005

Dear Mr. Cousins:

Enclosed is a set of questions for the YMCA from Subcommittee Member, Congressman Harold Ford, as a follow-up to your testimony at the Subcommittee on Oversight June 29, 1987 hearing on unrelated business income tax.

Please respond in writing, as soon as possible, to the questions for the YMCA. Also, please provide a copy of your response to Congressman Ford. Your response will be included in the Subcommittee's printed record of the hearing.

If you have any questions, please contact the Subcommittee on Oversight staff at (202)225-5522.

Sincerely,

JJPickle

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/tmw
Enclosure

cc: Congressman Ford

RESPONSES TO QUESTIONS FROM CONGRESSMAN HAROLD FORD BY SOLON B. COUSINS, EXECUTIVE DIRECTOR, YMCA OF THE USA

1. Why is it in the public interest to grant tax-exemption for adult fitness programs?

YMCA adult fitness programs have always been exempt from federal, state, and local taxes because policy-makers recognized the public interest in encouraging community fitness programs. Today, that public interest is clearer than ever. Public health officials are unanimous on the need for greatly increased participation in fitness and other health promotion programs. The landmark 1979 Surgeon General's report, Healthy People, summarized the case for health promotion in these words:

> There are three overwhelming reasons why a new strong emphasis on prevention -- at all levels of government and by all our citizens -- is essential. First, prevention saves lives. Second, prevention improves the quality of life. Finally, it can save dollars in the long run. In an era of runaway health costs, preventive action for health is cost effective.

Several key facts underscore the urgency of this message. Health care costs annually consume over $400 billion, almost 11% of GNP -- up from 5% in 1960. Additional expenditures for high-tech medical procedures clearly offer diminishing returns. Over 50% of all death and disability is now attributable to heart disease and other life-style related illnesses that can be prevented far more cost-effectively than they can be treated. An aging population promises still greater burdens in the future.

Greatly increased emphasis on prevention programs -- including fitness programs like those of the YMCA -- offers the only realistic prospect for reversing these trends. As former Surgeon General Jesse L. Steinfeld has stated:

> Physical fitness and other health promotion programs like the National YMCA programs are now recognized by the medical community as an integral part of overall health care. The Surgeon General and other officials responsible for federal health care policy have clearly and emphatically stated that it is the policy of the federal government to encourage greatly increased participation in such programs. (Emphasis added.)

However, levels of participation in adult fitness programs remain far below those required to achieve significant public health benefits. In 1980, the

Department of Health and Human Services advocated increasing the percentage of adults engaged in regular exercise from 35% to over 60% by 1990. However, a mid-decade assessment indicates that by 1985 participation levels may actually have fallen.

The exemption from federal, state and local taxes currently enjoyed by YMCA fitness programs enables YMCAs to offer these programs at a lower cost than would otherwise be possible. This lower cost encourages increased participation, the stated goal of federal health policy. Taxing YMCA adult fitness programs would plainly frustrate that policy.

2. How do you respond to the assertion by commercial health clubs that there are no significant differences between their fitness programs and those of the YMCA.

At least four key differences clearly distinguish YMCAs from commercial health clubs. First, YMCAs are nonprofit community service organizations operated solely for the benefit of their communities. No one owns a YMCA, except the community. No one profits from its operations, except the community. If a YMCA ends the year with an operating surplus, every dollar is plowed back into the community to expand YMCA programs. Commercial health clubs always have the option of converting to nonprofit status and seeking the same tax-exemption as a YMCA. The fact that not one commercial club has exercised this option strongly suggests that these clubs are, indeed, run for very different purposes than a YMCA.

Second, whereas commercial health clubs serve only those they can serve at a profit, YMCAs provide fitness programs for the whole community. Commercial health clubs typically concentrate on middle and upper income adults. YMCAs serve all ages, from pre-schoolers to seniors, and all income levels. YMCAs price memberships and programs to make them affordable to the communities they serve. YMCAs offer financial assistance to persons unable to pay. These policies reflect YMCAs' commitment to community service and accessibility. Community accessibility is also a requirement for tax-exemption. Under existing law, YMCA adult fitness programs are taxed unless the YMCA can demonstrate that the programs serve a broad segment of the community. No YMCA has ever failed this test.

Third, YMCAs are reliable, long-term providers of quality community fitness programs. YMCAs are committed to fitness because of our mission; commercial health clubs because of profits. This difference in motives translates into very clear differences in operations. We emphasize health education, rigorous staff training, medically sound programs, and the importance of a lifelong commitment to a healthy life-style. We have a solid record of financial stability and continuity of service. Commercial health clubs can make no such claims. While there are many reputable clubs, the industry, as a whole, has a well documented history of "fitness" fads, consumer fraud, high pressure sales tactics, and bankruptcy. Moreover, if and when profits diminish, commercial health clubs will exit as quickly as they entered, leaving YMCAs to meet communities' needs for fitness programs.

Finally, YMCAs earn their tax exemptions by serving their communities in a host of ways commercial health clubs never will. How many commercial health clubs offer after-school child care, youth sports, Youth in Government, youth employment, adult literacy, refugee resettlement, international exchanges, parent-child and family activities? YMCAs offer all of these programs. Many, including virtually all YMCA youth programs, are heavily subsidized with donated funds, volunteer labor, and, in many cases, with surplus funds from other programs. Each of these three sources of subsidy depends heavily on YMCAs' adult fitness programs. Where adult programs generate a cash surplus, the connection is obvious. Perhaps more important, adult fitness programs draw into the YMCA thousands of persons who go on to become volunteer leaders and financial contributors.

3. Commerical health clubs have also asserted that YMCAs are building their new facilities in affluent areas while closing older facilities in poorer areas. Is this true?

No. A June 1987 study by the YMCA of the USA Research Department indicates that of the 62 new YMCAs established since the beginning of 1985, 42% are located in and serve communities in which the median household income is below the national average. The commitment to serve low-income communities reflected in these national data is equally apparent in the capital investment budgets of major YMCAs around the country. For example, the Philadelphia YMCA has invested $7 million in inner-city facilities in the last five years. The Los Angeles YMCA recently opened a $5.5 million program center in the heart of Watts and plans another $2.5 million facility in a poor Hispanic community in East Los Angeles. The Chicago YMCA invested $8 million in its New City YMCA serving the low-income Cabrini Green community, and is building a $9 million facility in the impoverished southside community of Woodlawn. The Washington, D.C. YMCA's board has just approved a capital campaign for a new $5 to 6 million center serving inner-city youth. The list could go on, but the point is clear. Unlike commercial health clubs, YMCAs are committed to serving the whole community.

4. Have YMCAs become more dependent for revenue on earned income like membership dues and program fees as opposed to charitable contributions?

No. As the data in the following table demonstates, there have been no drastic fluctuations in either program-related income or charitable contributions over the period from 1950 to 1985.

YMCA Revenue Trends 1950-1985
(All entries are percentages of total revenue)

	1950	1955	1960	1965	1970	1975	1980	1985
1. Total program related income	72.8	67.9	66.9	68.0	72.6	74.4	70.4	72.9
a. Membership Dues	11.2	12.6	14.9	18.0	24.1	27.8	27.7	29.5
b. Program Fees	16.0	14.7	16.3	20.0	24.8	30.3	37.2	35.1
c. Residence and other	45.6	40.6	35.7	30.0	23.7	16.3	5.5	8.3
2. Contributions	20.3	22.3	22.7	22.0	20.1	17.5	18.8	18.3
3. Government Grants	*	*	*	*	*	*	8.5	4.8
4. Other	6.9	9.8	10.4	10.0	7.3	8.1	2.3	4.0

*Government grants included in line 4, "Other."

These data clearly refute the view of history often advanced by health club representatives in the competition debate -- that there was a golden age in which YMCAs were funded primarily by charitable contributions, and that current dependence on program-related income reflects a recent and dramatic fall from this state of grace. The "program-related income" line of the table tells a very different story. Such income accounted for 72.8% of YMCA revenue in 1950 and 72.9% in 1985. Correspondingly, charitable contributions accounted for 20.3% in 1950 and 18.3% in 1985.

5. Do YMCAs engage in unrelated business activities?

Relatively, few YMCAs engage in unrelated business activities for which they must file a Form 990-T, and even for these YMCAs, unrelated business income accounts for an insignificant amount of total revenue. Because so few YMCAs engage in unrelated business activities, the YMCA of the USA has never solicited information about such activities in its annual survey of local YMCAs. However, a recent survey of 20 YMCAs revealed that only one has ever engaged in any unrelated business activity. In this one case, the YMCA had operated a parking lot on debt-financed property, which the YMCA sold ten years ago. The experience of the YMCA of the USA legal staff, which routinely advises local YMCAs on tax matters, suggests that the results of this survey are typical of YMCAs nationwide.

The foregoing table provides a further indication of the insignificance of unrelated business income for YMCAs. Any unrelated business income received by local YMCAs would be reported in the "Other" category or the "Investment Revenue" category on the table. These categories together comprise only 4.0 percent of total revenue. Moreover, the bulk of the revenue reported in even these two quite small revenue categories plainly is not unrelated business income. "Investment Revenue" consists overwhelmingly of passive investment income from YMCA endowments, which is explicitly exempt from unrelated business income tax. Likewise, the "Other" income category includes revenue from annual fundraising events, sales of capital assets, and various other types of income not subject to unrelated business income tax.

For the relatively small number of YMCAs that do have unrelated business income, the most common source of this unrelated income appears to be debt-financed real estate. For example, a YMCA may rent an unused portion of an old YMCA facility, or rent other property which has been donated to the YMCA. In either case, if the rented property is subject to a Mortgage or other indebtedness, a portion of the rental income must generally be reported as taxable unrelated business income. Another example of the sort of unrelated business activity engaged in by some YMCAs would be a commercial parking lot owned and operated by the YMCA on land adjacent to its facility. Taxable unrelated business income from all sources comprises a de minimis amount of total YMCA revenue, and there is no indication that the amount of such unrelated income is increasing.

6. Do current unrelated business income tax rules provide clear guidelines for determining whether YMCA fitness programs are tax-exempt?

Yes. In 1984, the IRS National Office issued a detailed Technical Advice Memorandum setting forth the standards for determining whether a YMCA adult fitness program qualifies as "related", and, therefore, non-taxable. (See IRS TECH. AD. MEMO. 8502002, 8/5/84). Under the standards established in this Technical Advice Memorandum, a YMCA adult fitness program is taxed unless the YMCA can demonstrate that the program serves a broad segment of the community. YMCAs audited by the IRS must document, through appropriate demographic data, that their adult fitness programs are, in fact, serving a broad segment of the community. The IRS devoted a lengthy chapter in its 1985 training manual for exempt organizations field agents to an explanation of these standards governing YMCA fitness programs. (see IRS Exempt Organizations Continuing Professional Education Technical Instruction Program for 1985, page 145). The IRS National Office has also listed "youth related organizations' operations of health club facilities for the general public", as a high priority audit issue for exempt organizations field agents. (see Exhibit 7950-1, Internal Revenue Manual Update, October 1987). As the foregoing actions make clear, the IRS has established clear and detailed guidelines for the tax treatment of YMCA adult fitness programs, and has established an active audit program to ensure that these standards are enforced.

[Congressman Ford submitted the following questions to Mr. John McCarthy of the International Racquet Sports Association. A response to the questions was not received.]

SUBCOMMITTEE ON OVERSIGHT

BERYL ANTHONY, JR., ARKANSAS
RONNIE G. FLIPPO, ALABAMA
BYRON L. DORGAN, NORTH DAKOTA
HAROLD FORD, TENNESSEE
CHARLES B. RANGEL, NEW YORK
ANDY JACOBS, JR., INDIANA

DICK SCHULZE, PENNSYLVANIA
BILL FRENZEL, MINNESOTA
WILLIAM M. THOMAS, CALIFORNIA
RAYMOND J. McGRATH, NEW YORK

Ex Officio:
DAN ROSTENKOWSKI, ILLINOIS
JOHN J. DUNCAN, TENNESSEE

Subcommittee on Oversight
Hearing

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515

SUBCOMMITTEE ON OVERSIGHT

COMMITTEE ON WAYS AND MEANS

ROBERT J. LEONARD, CHIEF COUNSEL
M. KENNETH BOWLER, STAFF DIRECTOR
BETH KUNTZ VANCE, SUBCOMMITTEE STAFF DIRECTOR

A.L. SINGLETON, MINORITY CHIEF OF STAFF
MICHAEL A. SUPERATA, COUNSEL TO THE MINORITY

July 27, 1987

Mr. John McCarthy
Executive Director
International Racquet Sports
  Association
112 Cypress Street
Brookline, Massachusetts 02146

Dear Mr. McCarthy:

Enclosed is a set of questions for the IRSA from Subcommittee Member, Congressman Harold Ford, as a follow-up to your testimony at the Subcommittee on Oversight June 29, 1987 hearing on unrelated business income tax.

Please respond in writing, as soon as possible, to the questions for the IRSA. Also, please provide a copy of your response to Congressman Ford. Your response will be included in the Subcommittee's printed record of the hearing.

If you have any questions, please contact the Subcommittee on Oversight staff at (202) 225-5522.

Sincerely,

JJ Pickle

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/tmw
Enclosure

cc: Congressman Ford

Questions for YMCA Witnesses

1. Why is it in the public interest to grant tax exemption for adult fitness programs?

2. How do you respond to the assertion by commercial health clubs that there are no significant differences between their fitness programs and those of the YMCA?

3. Commercial health clubs have also asserted that YMCAs are building their new facilities in affluent areas while closing older facilities in poorer areas. Is this true?

4. Have YMCAs become more dependent for revenue on earned income like membership dues and program fees as opposed to charitable contributions?

5. Do YMCAs engage in unrelated business activities?

6. Do current unrelated business income tax rules provide clear guidelines for determining whether YMCA fitness programs are tax-exempt?

Questions for Commerical Health Club Witnesses

(Question for John McCarthy, Executive Director, International Racquet Sports Association.) Mr. McCarthy, I have here a copy of a letter that you sent in December of 1984 to the Board and Strategic Planning Committee of the International Racquet Sports Association, a copy of which you shared at the time with an official of the Washington, D.C. YMCA.

The letter opens by stating that you had "completed an investigatory trip to three markets in which the issue of unfair competition between YMCAs and clubs has generated considerable heat". You note that there had been a failure to communicate between YMCAs and the commercial clubs in these cities and that "because of this failure to communicate, the fact base of club contentions about the Y's was erroneous."

After citing several examples, you conclude that, "From my experiences in Portland, Washington, and Rochester, as well as Denver, Chicago, Boston and New York City, I have come to the conclusion that allegations that the Y's are no longer serving their social mission are not based on investigation of the facts." (Emphasis in the original)

How do you account for the rather dramatic change between the views expressed in this letter and those you have presented to the subcommittee this morning?

2. Your December 1984 letter also states that while commercial clubs have "alleged that the Y's are suddenly entering the adult fitness market ... the fact is that the Y's have been pursuing adult fitness since the beginning of the twentieth century."

Given this fact, should YMCAs lose their tax exemption just because entrepreneurs now decide they can make a profit by providing adult fitness facilities to some of the people traditonally served by YMCAs? What happens if commercial club owners stop making a profit? Will they continue to provide community fitness programs as the YMCAs have for decades?

3. Do the commercial clubs affiliated with the International Racquet Sports Association have a policy, like YMCAs do, of providing scholarships to people unable to pay their fees?

4. I have here an article from the April 3, 1987 Wall Street Journal entitled, "Fiscal Fitness: Efforts to Regulate Health Clubs Fail to End Abuses." While I am sure there are many highly reputable clubs within the membership of your trade association, this article describes a widespread pattern of consumer complaints about high pressure marketing practices and frequent bankruptcy of commercial health clubs. Given these facts, can we really rely on commercial health clubs to meet the community fitness needs traditionally served by YMCAs?

IRSA
International Racquet Sports Association
112 Cypress Street
Brookline, Massachusetts 02146
617 / 734-8000

December 27, 1984

Thomas H. Fulcher, Jr.
Senior Vice President
YMCA of METROPOLITAN WASHINGTON
1711 Rhode Island Avenue, NW
Washington, DC 20036

Dear Tom:

Thank you for the copy of the Y's Annual Report.

I've enclosed a letter that I wrote to the IRSA Board of Directors and Steering Committee after my visit with some of the Y's across the nation. Thought it might be of interest.

I will be in touch and please contact me if I can be of servic

Regards,

John McCarthy
Executive Director

Enclosure

JMC/ph

IRSA
International Racquet Sports Association
112 Cypress Street
Brookline, Massachusetts 02146
617 / 734-8000

Dear Board and Strategic Planning Committee:

I have completed an investigatory trip to three markets in which the issue of unfair competition between YMCA's and clubs has generated considerable heat.

In each of these markets (Washington, D.C., Rochester, N.Y., and Portland, OR), I found similarities that I list as follows:

1. In none of the markets was the leadership of the club community communicating with the leadership of the Y community.

   In each case, there was public and private bickering, but no effort to address issues on a person-to-person basis.

   Further, in each market, I had no difficulty in reaching the topmost levels of Y staff and Board leadership.

   In short, Step I toward resolving differences had not taken place in any of these markets.

2. Because of this failure to communicate, the fact base of club contentions about the Y's was erroneous.

   To mention several illustrative examples:

   a) It had been alleged that the Portland YMCA's were only serving the wealthy.

      The Portland YMCA was able to show me two public documents which read "None Shall be denied participation in any Y programs by reason of financial difficulty."

   b) It had been alleged that the Rochester YMCA did not serve children.

      In my three hour visit, I saw at least 30 children involved in Y programs.

   c) It had been alleged that the Downtown Washington Y no longer served the poor.

      The day before I arrived, the Y had presented a check for $10,000 to the Ethopian Relief Fund. A weekly Food Bank for the aged poor operates out of the Y.

From my experiences in Portland, Washington, and Rochester, as well as Denver, Chicago, Boston and New York City, I have come to the conclusion that allegations that the Y's are no longer serving their social mission are not based on investigation of the facts.

3. It is alleged that the Y's are suddenly entering the adult fitness market.

   The fact is that the Y's have been pursuing adult fitness since the beginning of the twentieth century. President Theordore Roosevelt worked out at the Washington, DC YMCA. Colonel Naismith invented basketball in the Springfield Y. Joe Sobek invented racquetball in the Greenwich Y. Volleyball originated in the Y. The Y/American Red Cross swim program has been the country's swim program for 40 years.

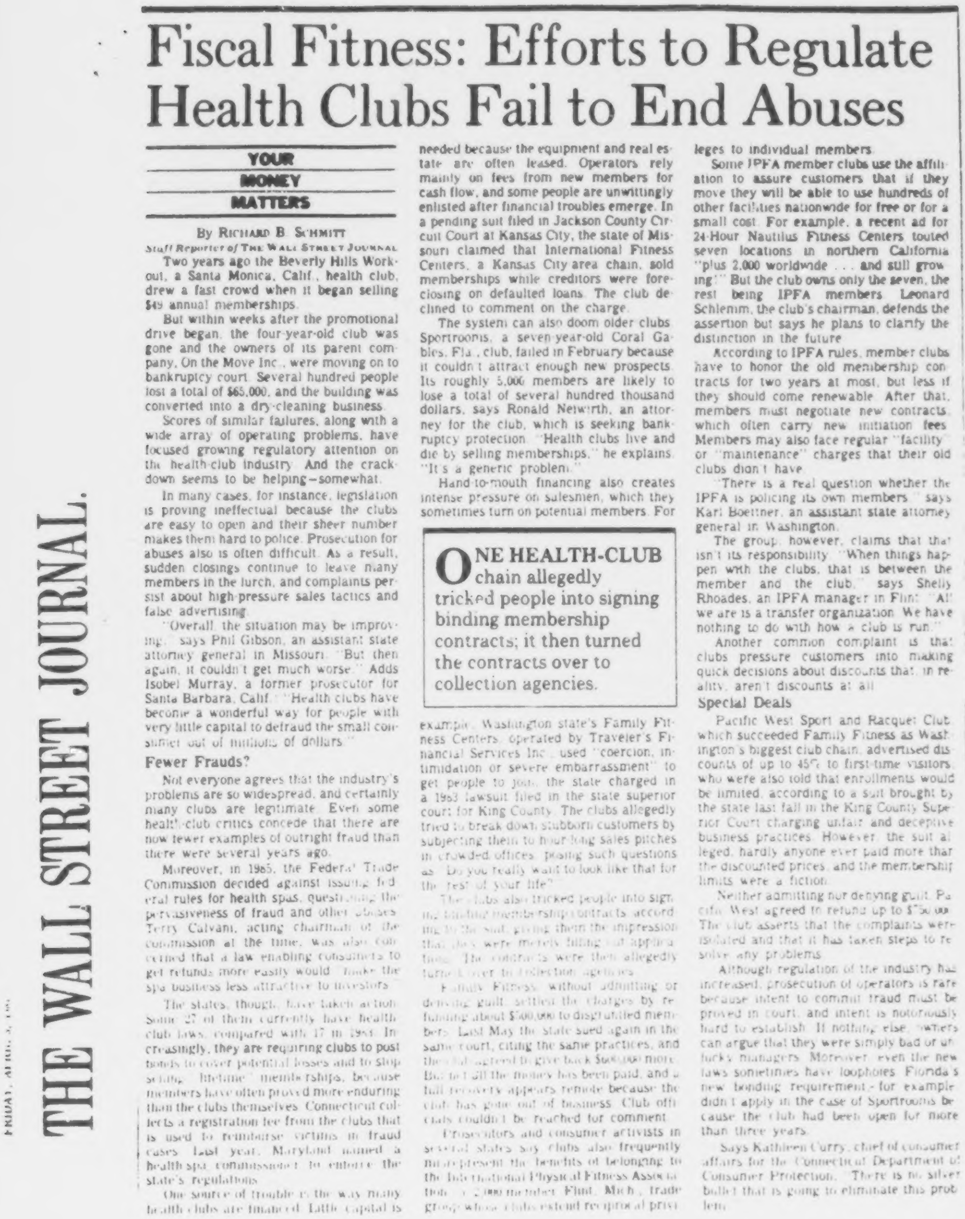
In short, wherever I have gone, I have found much discussion based on untested facts and assumptions.

Regards,

JMC (ph)

John McCarthy
Executive Director

JMC/ph



THE WALL STREET JOURNAL.

FRIDAY, APRIL 3, [illegible]

Fiscal Fitness: Efforts to Regulate Health Clubs Fail to End Abuses

YOUR MONEY MATTERS

By Richard B. Schmitt
Staff Reporter of The Wall Street Journal

Two years ago the Beverly Hills Workout, a Santa Monica, Calif., health club, drew a fast crowd when it began selling $49 annual memberships.

But within weeks after the promotional drive began, the four-year-old club was gone and the owners of its parent company, On the Move Inc., were moving on to bankruptcy court. Several hundred people lost a total of $65,000, and the building was converted into a dry-cleaning business.

Scores of similar failures, along with a wide array of operating problems, have focused growing regulatory attention on the health-club industry. And the crackdown seems to be helping—somewhat.

In many cases, for instance, legislation is proving ineffectual because the clubs are easy to open and their sheer number makes them hard to police. Prosecution for abuses also is often difficult. As a result, sudden closings continue to leave many members in the lurch, and complaints persist about high-pressure sales tactics and false advertising.

"Overall, the situation may be improving," says Phil Gibson, an assistant state attorney general in Missouri. "But then again, it couldn't get much worse." Adds Isobel Murray, a former prosecutor for Santa Barbara, Calif.: "Health clubs have become a wonderful way for people with very little capital to defraud the small consumer out of millions of dollars."

Fewer Frauds?

Not everyone agrees that the industry's problems are so widespread, and certainly many clubs are legitimate. Even some health-club critics concede that there are now fewer examples of outright fraud than there were several years ago.

Moreover, in 1985, the Federal Trade Commission decided against issuing federal rules for health spas, questioning the pervasiveness of fraud and other abuses. Terry Calvani, acting chairman of the commission at the time, was also concerned that a law enabling consumers to get refunds more easily would "make the spa business less attractive to investors."

The states, though, have taken action. Some 27 of them currently have health-club laws, compared with 17 in 1983. Increasingly, they are requiring clubs to post bonds to cover potential losses and to stop selling "lifetime" memberships, because members have often proved more enduring than the clubs themselves. Connecticut collects a registration fee from the clubs that is used to reimburse victims in fraud cases. Last year, Maryland named a health-spa commissioner to enforce the state's regulations.

One source of trouble is the way many health clubs are financed. Little capital is needed because the equipment and real estate are often leased. Operators rely mainly on fees from new members for cash flow, and some people are unwittingly enlisted after financial troubles emerge. In a pending suit filed in Jackson County Circuit Court at Kansas City, the state of Missouri claimed that International Fitness Centers, a Kansas City-area chain, sold memberships while creditors were foreclosing on defaulted loans. The club declined to comment on the charge.

The system can also doom older clubs. Sportrooms, a seven-year-old Coral Gables, Fla., club, failed in February because it couldn't attract enough new prospects. Its roughly 5,000 members are likely to lose a total of several hundred thousand dollars, says Ronald Neiwirth, an attorney for the club, which is seeking bankruptcy protection. "Health clubs live and die by selling memberships," he explains. "It's a generic problem."

Hand-to-mouth financing also creates intense pressure on salesmen, which they sometimes turn on potential members. For example, Washington state's Family Fitness Centers, operated by Traveler's Financial Services Inc., used "coercion, intimidation or severe embarrassment" to get people to join, the state charged in a 1983 lawsuit filed in the state superior court for King County. The clubs allegedly tried to break down stubborn customers by subjecting them to hour-long sales pitches in crowded offices, posing such questions as "Do you really want to look like that for the rest of your life?"

> ONE HEALTH-CLUB chain allegedly tricked people into signing binding membership contracts; it then turned the contracts over to collection agencies.

The clubs also tricked people into signing binding membership contracts, according to the suit, giving them the impression that they were merely filling out applications. The contracts were then allegedly turned over to collection agencies.

Family Fitness, without admitting or denying guilt, settled the charges by refunding about $500,000 to disgruntled members. Last May the state sued again in the same court, citing the same practices, and the club agreed to give back $600,000 more. But not all the money has been paid, and a full recovery appears remote because the club has gone out of business. Club officials couldn't be reached for comment.

Prosecutors and consumer activists in several states say clubs also frequently misrepresent the benefits of belonging to the International Physical Fitness Association, a 2,000-member Flint, Mich., trade group whose clubs extend reciprocal privileges to individual members.

Some IPFA member clubs use the affiliation to assure customers that if they move they will be able to use hundreds of other facilities nationwide for free or for a small cost. For example, a recent ad for 24-Hour Nautilus Fitness Centers touted seven locations in northern California "plus 2,000 worldwide . . . and still growing!" But the club owns only the seven, the rest being IPFA members. Leonard Schlemm, the club's chairman, defends the assertion but says he plans to clarify the distinction in the future.

According to IPFA rules, member clubs have to honor the old membership contracts for two years at most, but less if they should come renewable. After that, members must negotiate new contracts, which often carry new initiation fees. Members may also face regular "facility" or "maintenance" charges that their old clubs didn't have.

"There is a real question whether the IPFA is policing its own members," says Karl Boettner, an assistant state attorney general in Washington.

The group, however, claims that that isn't its responsibility. "When things happen with the clubs, that is between the member and the club," says Shelly Rhoades, an IPFA manager in Flint. "All we are is a transfer organization. We have nothing to do with how a club is run."

Another common complaint is that clubs pressure customers into making quick decisions about discounts that, in reality, aren't discounts at all.

Special Deals

Pacific West Sport and Racquet Club, which succeeded Family Fitness as Washington's biggest club chain, advertised discounts of up to 45% to first-time visitors who were also told that enrollments would be limited, according to a suit brought by the state last fall in the King County Superior Court charging unfair and deceptive business practices. However, the suit alleged, hardly anyone ever paid more than the discounted prices, and the membership limits were a fiction.

Neither admitting nor denying guilt, Pacific West agreed to refund up to $750,000. The club asserts that the complaints were isolated and that it has taken steps to resolve any problems.

Although regulation of the industry has increased, prosecution of operators is rare because intent to commit fraud must be proved in court, and intent is notoriously hard to establish. If nothing else, owners can argue that they were simply bad or unlucky managers. Moreover, even the new laws sometimes have loopholes. Florida's new bonding requirement, for example, didn't apply in the case of Sportrooms because the club had been open for more than three years.

Says Kathleen Curry, chief of consumer affairs for the Connecticut Department of Consumer Protection: "There is no silver bullet that is going to eliminate this problem."

Mr. DORGAN. Let me ask two questions and then call on other members of the subcommittee. First, let me say that I am a member of both organizations. I have been a member of a YMCA and also have been a member of a racquet club, a couple of racquet clubs, in fact. I understand what both of you have said today and I think you have presented thoughtful and interesting testimony and framed the question for the subcommittee. Let me ask, Mr. Cousins and representatives of the YMCA, to respond, if you will, to the question that Mr. McCarthy posed. Actually, he posed it in the form of a statement. He says, finally, across the country, YMCA's have abandoned facilities built to serve the homeless and disadvantaged and opened new facilities to provide for the athletic and fitness needs of professional men and women.

That kind of statement, I guess, gets at the crux of the argument that has been made on this side of the panel. Let me ask if you would respond to that. What kind of facilities have been abandoned across the country? What kind of facilities have been added? And what is the current commitment of the YMCA with respect to the disadvantaged and others who need assistance in order to get into a club in order to participate in these activities?

Mr. COUSINS. It is quite true, Mr. Dorgan, that the YMCA has replaced many of its old facilities in downtown areas, buildings that simply were too old to function. But I will tell you, people in Philadelphia and Los Angeles and Boston and San Antonio and cities all across the country, would be very surprised to hear that they were not investing money in the inner-city and that they were abandoning these areas. That is simply not the case. YMCAs have invested millions and millions of dollars in recent years in the inner-city. And this investment will continue at least for the next 10 or 15 years, until our old buildings have been replaced so that we ensure that our inner-city services are maintained.

Mr. BETTS. If I could follow Mr. Cousins on that? Let me give you an example. Some years ago, the YMCA in Chester, PA, south of Philadelphia, which had not been part of the Philadelphia Y corporation, went bankrupt. It had a 65-room residence and 75,000-square-feet of space. It was 25 years old. It had lost $150,000 a year for the preceding 3 years before it was boarded up. The Philadelphia Y came to Chester because Chester is one of the most economically blighted communities on the eastern seaboard. We took the boards down and reopened that YMCA, and we have invested $286,000 to cover operating losses and $242,000 for capital redevelopment, through the year 1986. Our investment in this poverty community will reach $600,000 by the end of 1987, in order to renew and rebuild that YMCA. That Y now provides large child care services, summer care services, and is working in a community with the highest unemployment rate anywhere northeast of here that I am aware of.

But the 65 residence rooms are not operative and the reason is that we simply cannot operate the residence rooms without driving everyone else away from that facility. Mothers will not bring their children and so on. We desperately want to do more for the homeless, but the hard reality is that communities will not fund the YMCA to build large new residences. The Y is peculiarly an organic product of the will of the community, and communities will not give us $4 million or $5 million to rebuild residences built in 1910, but they will help us to reach to kids, to run programs that educate and get employment for people and get people off of drugs. The reality is that even in the most needy of communities, we cannot operate the residence, despite the fact that we are investing and incurring tremendous losses to be there and to help where we are needed most.

Mr. DORGAN. Well, might I just inquire if Mr. Garrett, when he this morning appeared at the YMCA here in Washington, DC, had not been the well-dressed, well-spoken man that he is, but instead, been someone sort of down on his luck, out of a job, did not have any money, but wanted to take advantage of some of the facilities there, how would Mr. Garrett, in that circumstance, be able to participate in the programs here or in your cities at the YMCA?

Mr. BETTS. I think that what would have happened would have been that the people at that front desk would have conceived that Mr. Garrett did not necessarily need a swim in the pool, but that he needed help of other YMCA agencies or other agencies in the community to deal with the problem he was facing and I tell you, Mr. Dorgan, he would have gotten that help. He would have gotten that counsel and that referral at that desk. He walked into that building as a man who was not a member and who insisted on using it on an instantaneous basis. I am sure that if he had walked into a hospital, not sick, and asked for the same privilege to wander the building, he would have gotten the same answer.

Mr. COUSINS. I would like to add to that. Mr. Garrett took several shots at the Washington Y. As a matter of fact, we are very proud of that facility. It replaced an old dump of a building that was in full view of the whole Nation, some people act as if that is the only facility and the only program that the Washington YMCA offers. In fact, the Washington YMCA offers programs of a tremendous variety for youth and adults all over the city. The downtown Y happens to serve primarily an adult fitness need. But that Washington YMCA is much deeper and broader than Mr. Garrett would try to portray it.

Mr. BETTS. Mr. Garrett did not mention that that YMCA has, in the last couple of weeks, committed to the creation of a $5 million youth facility in the black community in Washington. He did not mention that in the Adams-Morgan area, there is a Hispanic center of that YMCA that is providing senior services and youth services on a broad scale and that there is another urban center in another black community of the Washington Y. He did not mention that there is an elementary school and junior high program to combat drug abuse provided by the Washington YMCA in the city schools of the District of Columbia. He did not mention a great many things.

Mr. DORGAN. Let me, if I might, direct a question to Mr. McCarthy, Mr. Eisenzimmer, and Mr. Garrett. I understand what you are saying, but then I grew up in a community with a little different perspective because the only facilities we had, for example, for racquetball, were at the YMCA. Years later, a private club was built. There are no indoor tennis facilities in the town of 50,000 where I grew up and if there ever are to be any, they will probably be at the Y. It is unclear at this point whether they are ever going to get a couple of indoor tennis courts, but, you know, I think the YMCA has done some awfully good things in some of these communities. I would guess that you believe that, as well.

You are saying, I think, that the Y's mission has changed and it has become a more direct competitor in the adult fitness center area and I am trying to understand a little more about your judgment about the YMCA's commitment, for example, to minority youth, to those in the lower income areas. Mr. McCarthy, specifically, in part of the material for preparation for this hearing, we were furnished with some information that you had distributed in 1984, I guess, saying that, in your judgment, having looked at some of these Y's, they have not abandoned their commitment to the low income folks and others. Has your position changed on that at this point and what is your perception of the YMCA's commitment?

Mr. McCARTHY. Remember, our position is a highly defined position. We recognize and applaud the many, many YMCA's there are, but we believe that an impartial investigator, as has occurred in Topeka, in Pittsburgh, in Portland, and in two communities in Illinois, there are some Y's in this country, the Washington, DC National Center Y is a case in point, that no fair-minded person, would call a public charity. I would like to know the average income level of the members of that specific facility. I would like to know the average income level of the new Steadman YMCA across from the Western Boniventura Hotel in L.A. I would like to know the average income level of the new Y in Dallas, of the new Y in Houston. We are talking specific facilities. We are not making any broad, blanket statements about the YMCA.

Mr. EISENZIMMER. In answer to your question, may I proceed?

Mr. DORGAN. Yes.

Mr. EISENZIMMER. Thank you very much. What is actually happening, the YMCA is saying they are replacing these old buildings. In replacing these old buildings, they are building state-of-the-art athletic clubs and when they build these state-of-the-art athletic clubs, they are taking on tremendous debt services. They are not able to pay these debt services by letting in the disadvantaged and the poor, they must go for the market that can help pay the bills and in doing so, they are excluding the poor and they are addressing our market. That is our problem.

I would also state that many of the claims that the YMCA is making about specific clubs, as Mr. McCarthy says, there are some clubs that do help the children and the disadvantaged are able to use them. There are many clubs, those in Portland, where they bring the children in, take pictures of them for their public relations benefits, and then get the children out and print the pictures of all the things they are doing for the kids when, in fact, if you look at the schedule, the YMCA's schedule for the day, the children are not even allowed in the club. And when they are allowed in the club, it is on a weekend, and they have to be with someone who is an adult. So the things that they claimed that they are making are just not holding water with many, many of the YMCA's that are competing with our particular industry across the country.

Mr. COUSINS. Mr. Chairman, you simply cannot isolate these individual facilities from the overall program of the YMCA. The average income level of one facility does not mean a thing, anymore than it does with their clubs. At the Portland YMCA, for example, half their membership is under 18 years of age. You just simply cannot aim at one facility and ignore the YMCAs overall services to the community. And I would like to say something about the tax issue. The word has evidently not reached the commercial health club industry that the State of Illinois has just reaffirmed the tax exemption of all YMCA's in that State. And the definition of charity used by the tax assessor in Portland, was so narrow that the Ventura Boys Club that Mr. Garrett is attached to might be put on the tax rolls.

Mr. DORGAN. My time has expired. The Chair recognizes Mr. Schulze for inquiry.

Mr. SCHULZE. Thank you, Mr. Chairman. I, too, would like to thank the panel for having framed an issue very succinctly and it is most helpful to this committee. Mr. Cousins, in February, I received a letter from Glenora Putnam and Gwendolyn Baker in which they put forth the YMCA position and stated that, in contrasting tax exempt versus taxpaying businesses or entities, that businesses provide only services that make a profit for their owners, receive support only through buying of goods, services or stock, and while subject to some Federal regulations, are not generally accountable to the public or the community. Having spent 25 years as a small businessman in a town, I think that most small businesses are fairly accountable to the public. If not, they would not be there. I think that accountability is something which goes along with the existence in a small business, and I wondered what your perspective as an organization, is right on this issue. Do you care to comment on that?

Mr. COUSINS. Well, Ms. Putnam and Gwen Baker are the national leaders of the YWCA, not the YMCA.

Mr. SCHULZE. Oh, it is the YWCA, thank you.

Mr. COUSINS. While we would not agree, we would agree that everybody ought to be accountable. We certainly feel that we should be to the IRS and to everybody else and we believe that health clubs are accountable.

Mr. SCHULZE. You see how closely I looked at it? I saw the triangle and it looked like the YMCA. Do you get confused that way often? All right, Mr. Cousins, would you tell me a little bit about where your headquarters is located, how the lines of communication work, and the funding? In other words, if I wanted to start a YMCA or if I were a minister in a small town in Astibula, Ohio, and I want to start a YMCA for the community, how do I go about it? Who provides the money? Where does it come from? If there is profit, where does that profit go? Is there a franchise? Do I have to buy a franchise? From whom do I buy it and how do they get the right and so forth? Would you just give me some of those lines of communication?

Mr. COUSINS. Yes, Mr. Schulze. First, our headquarters is in Chicago. We have 100 people on our staff serving the Nation from that headquarters. We have five field offices geographically distributed. If, in a community, a group of citizens want to start a Y, it usually comes this way. Someone has been a part of a YMCA in another town and feels that it would be a good thing for this new community where he or she resides. And so they will either ask a neighboring community YMCA how to do it, or they will go back through our national field system and get assistance. We have an extension department which is located in Dallas that serves the whole Nation. And then we will visit, at our expense, this community, to speak with those citizens that want to start the Y to tell them what it takes to really get going.

Most people think you immediately start with a building. We do not. We start in churches, we start in homes, working with a small corps of citizens who give some money and lots of time to get the Y going. The YMCA of the USA in turn, provides planning help, financial development help, fiscal management help, recruitment help for staff; all of that is a part of our national service to our members. And our members pay for our overhead through their dues to us.

Mr. SCHULZE. Is this the way that most Y extensions come about or are they internally generated and if they are, then how is that decision made?

Mr. COUSINS. If there is no YMCA in the community, that is the way a new Y is established, and the money is raised locally. We do not put money into a community from a central location. In the case of a larger city, as in Philadelphia, the leadership of the metropolitan YMCA will work with residents of suburban areas or other parts of the community that have expressed an interest in establishing a new YMCA. The metropolitan YMCA staff will provide in establishing the new Y that national staff would provide in a smaller community. But we are always ready to help with the planning and with the support system that will help a YMCA succeed.

Mr. SCHULZE. I am somewhat confused. If I am in a suburban area and I want to start a YMCA, can I just start it? What do I have to do to put YMCA on my building?

Mr. COUSINS. Well, there are several requirements.

Mr. SCHULZE. That is what I am asking. Do I start it or does somebody, let's say, in Philadelphia, say I want to have a YMCA in Bucks County or Lancaster County and we will go out there——

Mr. COUSINS. Oh, no, it starts in the community. It is very seldom that, from a central location, people would treat it as a marketing venture into a new area. New YMCAs generally pop up from those neighborhoods and from those communities and then get service from established units.

Mr. SCHULZE. Tell me about the flow of money.

Mr. COUSINS. The money is raised locally for the YMCA. Programs are begun. In the YMCA that I belong to in North Brook, IL, the YMCA was started with a day camp where parents paid for their children. There was some money raised to help subsidize that, and then other programs come into being. Sooner or later in this development, a new YMCA will raise enough money to build a building and then people pay membership fees and program fees to underwrite its operation.

Mr. SCHULZE. In your testimony, you say all of the money raised in a community stays in that community, is that correct?

Mr. COUSINS. Local YMCA's pay dues to the YMCA of the USA—just as clubs pay IRSA dues. We have a national plan to support these services that an individual YMCA could not manage on their own, training of staff, for example, recruitment, public relations help, fundraising, research.

Mr. SCHULZE. Are those dues comparable to other national organizations, a few cents, a few dollars, are they thousands of dollars, hundreds of thousands of dollars, what kind of fees? Are they based on the number of people involved in the activity? Are they based on the size of the facility?

Mr. COUSINS. The size of the unit. That is correct.

Mr. SCHULZE. I beg your pardon?

Mr. COUSINS. On the average, it is the size of the unit. About 2 percent——

Mr. SCHULZE. Square footage?

Mr. COUSINS. No, 2 percent of the expense budget of a local YMCA.

Mr. SCHULZE. Two percent of the gross of an establishment?

Mr. COUSINS. Generally speaking.

Mr. SCHULZE. And how much does that amount to? That all then goes to Chicago?

Mr. COUSINS. That comes into our central headquarters. Our budget, for example, for the total national organization is about $25 million. Significantly, our budget for the national organization is about what it was 7 years ago. Out of the total revenue of the national Y, half comes from our dues. The other half comes from endowment and from a variety of other sources.

Mr. BETTS. I think it is noteworthy that that is a very low percentage compared to other national organizations such as the Red Cross or the Salvation Army. It is a remarkably low percentage and there is one exception to what Mr. Cousins has said in regard to your question. Where we are going to develop a Y in an impoverished community, as we are in many cities across the country today, we will bring the money from the corporate and foundation community into that community because the money to build it is not there. Where the community is not impoverished, the community must develop its own resources.

Mr. SCHULZE. I do have more questions but my time has expired. Thank you, Mr. Chairman.

Mr. DORGAN. The Chair recognizes the gentleman from Texas.

Chairman PICKLE. Thank you, Mr. Chairman. I want to ask the YMCA group, do any of your organizations pay UBIT taxes?

Mr. ASHLEY. Yes, Mr. Chairman. As I indicated in my earlier remarks, a few YMCAs have, from time to time, received unrelated business income, and those YMCAs have filed 990–T's, they have paid whatever tax was shown due. But the amount of money, while I cannot quantify it with a dollar amount, is very, very small in relationship to the total.

Chairman PICKLE. Then, for all practical purposes, you do not pay UBIT. You did say that if there had been some particular real estate transaction in the sale of a piece of property, that there might be some UBIT. Otherwise, you do not pay any UBIT. That is generally across the country.

Mr. ASHLEY. That is correct.

Chairman PICKLE. And even when you do, you say, it is a very, very small amount. So essentially you do not pay UBIT. Everything is based on the fact that it is tax exempt. Now, do you have any income producing activities that are associated with joint ventures or partnerships?

Mr. Ashley. No, sir.

Chairman Pickle. So yours are operating YMCA's?

Mr. Ashley. The YMCA operates with the YMCA.

Chairman Pickle. Now, Mr. McCarthy had said that across the county, YMCA's have abandoned facilities built to serve the homeless and disadvantaged and have opened new facilities to provide for the athletic fitness needs of professional men and women. I assume that there is some truth to that in the sense that you do not provide residences any more. That is going out of style or it is going out of operation. So your operations have changed over the years, which is a normal sort of development. But you are getting out of the residence programs and you are going into other programs for almost anyone who comes in.

Mr. Cousins. Many, many rooms still exist. There are still 30,000 rooms around the Nation operated by YMCA's. Most of them now for runaways, for homeless people, there are endless examples of those around the Nation. They are not operated as residences, as they were 30 or 40 years ago.

Chairman Pickle. Well, if they are operated on that basis, that is commendable and there needs to be a place for that. Tell me, how do you justify the operation of the Beverly Hills yacht club or the yacht club out in California that somebody made reference to earlier.

Mr. Cousins. No, he made reference to a yachting class—how to sail a boat—as a part of the Beverly Hills YMCA program. Every YMCA has its programs tailored to what the people in that community want. I am sure that is not all the Beverly Hills YMCA does.

Chairman Pickle. How do you justify, then, that running a yachting club qualifies for tax exempt purposes?

Mr. Cousins. Well, the income from that yachting class probably helps send some kids to camp.

Chairman Pickle. Well then, on that basis, you could run any kind of business if the income goes back into helping the Y?

That gets into the UBIT area, but you do not pay that. It is hard for me to see how a yacht club or yacht classes, in any sense of the word, would be tax exempt, whether it is in Beverly Hills or whether it is in Podunk.

Mr. Betts. Mr. Pickle, at camps across the United States, since early in the 1900s, Y's have taught kids how to sail. They have taught them how to paddle canoes, they have taught them how to swim. That is not a yachting class. It is a sailing class and we have been doing that with rich kids and poor kids for 100 years. It is just one of the things a kid can do on water.

Chairman Pickle. Well, if you are doing that out there, how many poor kids do you think would be enrolled in the Beverly Hills yachting class?

Mr. Betts. I have no idea.

Chairman Pickle. Oh, yes, you do. You know there would be none.

Mr. THOMAS. Would the gentleman yield? In Beverly Hills, the poor kids have boats.

Chairman PICKLE. I beg your pardon?

Mr. THOMAS. The rich kids have the yachts, the poor kids have the boats.

Chairman PICKLE. Well, we have got a new class here. It sounds like we have got the yuppies, the yippies, and now it sounds like we have got the yachties, a new grouping entirely. I am not trying to be facetious about it. I think the average person's hair just rises when he says tax exempt, a yachting class? And I am just asking you or the other panelists, do similar examples like this exist over the country—classes of that sort or programs of that kind?

Mr. COUSINS. It is the YMCA that is tax exempt, not sailing classes.

Chairman PICKLE. Yes, I know. But are you saying then that they are not related? The fallacy seems to me to be what you are saying is that if that is income producing, it is justified because it goes back into the coffers to help the poor. Then, on that basis, you could hold that true for any organization that qualifies under 501(c). However, the purpose of the UBIT is that if it is unrelated, then they ought to be paying some taxes. But you do not pay any tax.

Mr. COUSINS. So far, we have met that test. We have satisfied the IRS that each of our programs, standing on its own two feet, is substantially related to our charitable purpose.

Mr. EISENZIMMER. Could I make a statement?

Chairman PICKLE. Wait just a minute. I will recognize Mr. Eisenzimmer.

Mr. EISENZIMMER. What I would like to point out is the mentality that the YMCA is using on this could be applied just about to any charity. The Salvation Army, which is a highly respected charity, for instance, because they have flop houses and soup kitchens, could open luxury hotels and very nice restaurants, and then say that the profits from those facilities would then go to help the disadvantaged in the community, and the hotel and restaurant association and, I am sure most of the public, would not hold still for that very long.

Chairman PICKLE. Now, Mr. McCarthy, you said in your statement that your organization, the IRSA, says that current law, as interpreted by the IRS, is inadequate to resolve either the proper tax treatment of income derived from a Y health club activities or the tax-exempt status of the YMCA fitness facilities.

Now, are you saying that there is some question with respect to how Internal Revenue Service has ruled on this question? The YMCA people said that every year they are audited and every year they meet the IRS qualifications and pass the test. They say that they have apparently been ruled by the IRS that they are not subject to the UBIT, and that everything they are doing is legal.

Now, you indicate to me that, as interpreted by the Internal Revenue Service, that they question that practice, that fitness qualification. Am I misinterpreting what you are saying?

Mr. MCCARTHY. What we are saying is that the UBIT is totally impractical in this specific case. The YMCA defines its mission as to contribute to the physical, spiritual, moral, intellectual development of its members. There is nothing unrelated to that purpose. There is nothing you can squeeze under that purpose so that UBIT is irrelevant to this case.

Mr. Betts. Mr. Pickle, if I might say one thing.

In 1905, the Philadelphia Y was building a downtown Y facility that served predominantly employed young men. It had the most avant-garde fitness facilities of the time, what the doctors recommended. That was medicine balls and Indian clubs. But it was the best the doctors knew at that time.

Today, we have the same kind of facilities. The image that we have always had rundown smelly facilities, and that's the only thing we ought to be allowed to operate, is just ridiculous. We're doing the same kinds of things we did a hundred years ago for employed people in the fitness area.

Chairman Pickle. Well, I'm sure that's true in many, many of your facilities Mr. Betts. And I don't question that that is a fact.

Our hearing this morning is to try to determine though at what point does an organization like the YMCA pay UBIT taxes, or should they? We are trying to determine not so much necessarily about who you serve, but really how it's operated within respect to this particular law.

Now, when I was a young man in west Texas, a little town of Big Spring, way out there, we had the YMCA. It was the only health club in town, and served everybody. It didn't make any difference who you were.

I don't know what the community would have done without it. And I imagine all across the land those kinds of Ys have just literally been the life blood for a community.

But, in the space of 50 or 75 years or more, those aspects have changed because you have got to "stay in business." And I think the practices have changed enough where we are trying to say, not that you do or you don't serve some of the underserviced or disadvantaged, but if you do get into other businesses, where do you draw a line? And apparently you've drawn a line where you pay no tax at all. We're trying to determine should you?

Now, we've been told that several localities have revoked the property tax exemption of YMCA fitness centers. They are just the local communities that apparently have said you don't get tax-exempt status any more because you're a business.

I'm just wondering if that's being done by some of the local communities? Is that a sort of a new standard that's being practiced? Is that being done throughout the country in many, many instances?

Mr. Cousins. No, it isn't. And as I mentioned earlier, the State of Illinois just reversed the local tax assessors who had put some of the YMCAs in our State on the tax rolls. They have now reaffirmed the tax exemption of the Y, and we believe we deserve it. We are willing to be put to the test by the IRS or by anyone else that everything we do is related to our mission.

And in the other instances, in Kansas and Oregon, we are certainly not letting that go by. The basis of that being put on the tax rolls was so narrowly defined that we think that's worth a challenge, not just by us, but by the Boys Clubs and the Salvation Army, and all other nonprofits that are serving the community.

Chairman Pickle. Well, let me just summarize my opinion.

I assume if you walk down here to the Washington YMCA, and you want to join the YMCA, they are going to let you join the YMCA, and they don't test you as far as your background or your income or your race or your personal feelings. If you need — Mr. Betts says counseling, you sign up and you join the club. That's for anybody.

Now, is that tax-exempt for the whole community? Can you just get into any kind of business? I don't think you could stay in business if you didn't let in almost anybody and also appeal to the business profession. That's going on in my city of Austin, TX, and the community pretty much accepts it.

We are not looking at the community's feeling so much as how should the law work. That's what we're looking at. And that's what we've got to continue to look at.

Thank you, Mr. Chairman.

Mr. DORGAN. The time of the gentleman has expired.

The Chair recognizes the gentleman from California, Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

Thank all of you for your testimony. This, I think, is another area which clearly points out in part behavior, but probably more importantly the inability of the current law to respond to current needs. And although people have asked us to look at the question of regulation, this particular discussion kind of goes to the heart of the problem as I see it.

Mr. Cousins, let me ask you some questions about the national because I read through the material and we didn't have much on the national.

Each local Y is kind of autonomous in terms of the programs they offer? I saw a compilation of the percentage of programs. This would come from the national as a service, and everybody pays a fee to the national.

What's the budget of the national? What's the name of it? What is it called?

Mr. COUSINS. It's called the National Council of the YMCA.

Mr. THOMAS. National Council.

What's the budget annually?

Mr. COUSINS. Our budget is $25 million.

Mr. THOMAS. About $25 million.

Do you offer services to the independents, the local Ys?

Mr. COUSINS. Yes, we do.

Mr. THOMAS. Marketing?

Mr. COUSINS. Yes.

Mr. THOMAS. Advertising?

Mr. COUSINS. Communications, research, the material that you quote from is provided by our national research department. We have a legal counsel. We have a fundraising department. We have an insurance department. We have a program department that offers services to local YMCAs for adult programs, youth programs.

Mr. THOMAS. So you have a kind of an outreach program in terms of what works and what doesn't if somebody wants to know. They have a program that's more traditional, it isn't working, you've got people that will come out to them and talk to them about what's new and working and encourage them to get into things like racquet ball or——

Mr. COUSINS. Yes.

Mr. THOMAS. Swimming classes, depending on the area that they are in, of course.

Mr. COUSINS. Yes, we do. We provide that service through our research department. We have teams that go in, it's called our special services division, and they'll help a community think through what's appropriate for that community.

Mr. THOMAS. Do you ever monitor what's working in the private sector and determine whether or not that's something that you ought to go into if you haven't been into it before?

Mr. COUSINS. We monitor what's going on in a community in all areas of service to youth, for example.

Mr. THOMAS. So if something isn't working in a community that the Y is putting on, but there's a private sector that's something going and it seems to be flourishing, you have examples, if we requested, where perhaps you observe that and indicate it to the national that this is something the Ys ought to go into?

Mr. COUSINS. There are some instances of that, but very few.

Mr. THOMAS. Why would you do that if it was already being provided by somebody else?

Mr. COUSINS. Well, we provide our programs within the context of our mission statement to promote the health and well-being of the whole person. We do not think it is inappropriate for a YMCA to offer a service just because someone in the commercial sector offers a similar service.

Mr. THOMAS. I understand that. That's part of the problem with the law.

We had that with the universities. Anyone taking their fundamental charter of helping mankind can go anywhere and do anything. We understand that. Some of us think that's part of the problem.

I've got a little bit of a concern. If you've got a national organization which watches the private sector to figure out what the public wants and then goes out and duplicates it under the tax-free sector, that's a little bit of my concern.

Now, if you've got advertising—excuse me?

Mr. COUSINS. You said that. I didn't say that. We are not——

Mr. THOMAS. The statement I made is totally incorrect?

Mr. COUSINS. We are not looking for ways to compete with the private sector.

Mr. THOMAS. No. You're looking for ways to service people and sometimes the private sector hits on various activities which people pay for that you see appropriate as falling under the broad charter granted to the Y.

Mr. COUSINS. Yes, sir.

Mr. THOMAS. You have no qualms about going in and competing directly with those people even those it was their idea.

Mr. COUSINS. Mr. Thomas——

Mr. THOMAS. Because of your charter. I understand exactly what you're saying. I just view it differently than you do I guess.

Mr. BETTS. Mr. Thomas, could I just add one thing briefly. The situation is the reverse. In the vast majority of cases, it is commercial businesses that are copying successful programs developed by YMCAs.

Mr. THOMAS. I won't care about the vast majority of cases, and I've heard enough platitudes. If there are specific examples of where you go out and cherrypick things that the private sector is doing, I have some concern.

There is no question the private sector has come up on the idea. But I don't think the YMCA invented physical fitness. Okay? So, you know, we've got points there.

Advertising, this is from Oregon. Do you folks screen advertising? Do you have legal counsel that goes over advertising for locals if they ask for it?

Mr. COUSINS. Yes, we do.

Mr. THOMAS. To make sure that it complies with the overall?

Mr. COUSINS. Yes. You only saw a few of the ads. And I've said before we are not without sin, Mr. Thomas, but we have 12 other ads that try to get kids to get to camp, we have family activity, we——

Mr. THOMAS. Well, maybe you won't answer my question before I ask it, okay?

Mr. COUSINS. Okay.

Mr. THOMAS. It says here it is the YMCA's philosophy to make services available to everyone regardless of his or her ability to pay. Do you quarrel with that?

Mr. COUSINS. No.

Mr. THOMAS. Oh, okay. Let me get my question out before you give me the answer.

If I go down to the Washington YMCA, and I want to use the facilities down there, as have been described, I have not been there and they sound quite nice, if I want to swim or use the various facilities, you've got various memberships for various activities with prices associated with each. If I wanted to utilize those facilities, but I didn't have the income to pay that price, do you buy down the price to individuals?

Mr. COUSINS. We provide scholarships for people who cannot afford to pay. And that's true in almost every YMCA across the country, if not all.

Mr. THOMAS. Scholarship to me denotes a grant that you get to use the facilities even though you can't pay for them. Well, I can pay for some of it, I just can't pay for all of it.

Do you have an ability to scale down the price on a descending income?

Mr. COUSINS. We have established already different prices for different activities.

Mr. THOMAS. No. The same activity, one person pays the full price, I'm a lower income so I would like to pay half the price and then, of course, those who don't have any income get the full price subsidized.

Do you have any arrangements like that at all?

Mr. COUSINS. People come in on the basis of their ability to pay. We try to make those arrangements.

Chairman PICKLE. Would the gentleman yield?

I don't think you're answering the question.

Mr. THOMAS. He hasn't, and I was going to keep going. You try it. [Laughter.]

Chairman PICKLE. A "poor person" of any level comes in, and he becomes a member of the Y. Does that entitle him to all of the services of that Y, everything? Can he use all the facilities, dining room, steam room, the games, the programs, the yachting classes and so forth? Is he entitled to all that, or has he just got a limited membership?

Mr. COUSINS. We have a sliding scale of memberships, depending on what people want and what they can afford to pay. And to the extent of our resources, we try as best we can to help people use those facilities according to their ability to pay on a sliding scale.

Chairman PICKLE. Well, an average person comes in, he's not wanting just one thing. He wants to join the Y and be able to use the Y. But you're saying to him when he joins up, he can't use all the facilities, he just can use only that which he paid for?

Mr. COUSINS. Well, we would do our best to have anybody who came in participate in the full array of services.

Chairman PICKLE. Well, that's not answering the question.

Mr. THOMAS. Let me try one more time.

The fellow who came in, as Mr. Betts described, a little bit more disheveled than Mr. Garrett, why do you assume you're going to hustle him off to counseling because that seems to be his need? Maybe he just wants to go ahead and use the facilities. He is not as well off as Mr. Garrett and can't afford to dress as well.

Rather than provide counseling, could he, if he said I'd like to participate in the activities but I don't have the income, do you have a specific program for that income, swimming for example, where I can pay 10 cents on the dollars or 50 cents on the dollar, or do you move him into a different program because of the type of person that he is?

Mr. ASHLEY. Mr. Thomas, the Washington Y, I am told, has 500 subsidized memberships set aside for low-income persons, and those members can use the full facility. I cannot give you all of the details on that, but they do have a large number of members who use full the facility on a subsidized basis.

Mr. THOMAS. Okay. The point I'm trying to make is that in response to a number of questions, the answer we continue to get was that we have these various programs, people pay the cost of these programs. But then we take some of that money and send a kid to camp.

That isn't, in my opinion, living up to the 501(c)(3) charter in terms of what you're doing. It ought to be in a like area where everyone, regardless of income, as this ad indicates, regardless of his or her ability to pay, and to the degree that we find YMCAs that have programs that require you to pay and that you don't have a buy down capability, which is the charitable concept from my viewpoint on all of your activities. But rather you say we have some activities over here for these folk that we support through the cost of these other programs, then I don't see how you can justify under your chart "these other programs," because they then are fully funded, paid for, and simply to me don't fit under your basic approach. That's what we are going to be looking at. That's the concern we have with the law.

Quickly, Mr. McCarthy, in your own testimony on page 3, you have the YMCA's original charter, as amended, describing its purposes. And when I read these purposes, you go on and say, however, today's YMCA activities extend far beyond its traditional role of ministering to the physical and spiritual needs of the poor and disadvantaged. I don't see anything in the charter that says that that's what they're doing.

They say to promote the physical, mental, social and spiritual welfare of persons. They don't put a dollar sign after those persons. So I think, you know, to that extent, they really aren't what you claim they ought to be, never have been according to their charter. That's the concern that we have, not that they're supposed to minister solely to the poor or the disadvantaged, but that the programs that they offer really truly reflect people's ability to participate regardless of their ability to pay.

I think, to a degree, we've got a bit of schizophrenia out there within a number of YMCAs where they think they're doing good and useful purposes for the disadvantaged on one hand but are beginning to fund it more and more often with programs that compete directly with the private sector and do not offer any charitable activities within that structure.

To the degree that you've got two separate operations under one umbrella, it gives me real concern about the way in which the law is used. That's the direction I'll be looking at.

Thank you very much for your testimony.

[The following was subsequently received:]

COMMITTEE ON
RECEIVED
AUG 7 1987
WAYS AND MEANS

RECEIVED
AUG 1 1 1987
Ways and Means
Subcommittee on Oversight

YMCA of the USA
Washington Office
[illegible]
[illegible]
Washington, [illegible]

(202) [illegible]

July 31, 1987

The Honorable Daniel Rostenkowski
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Rostenkowski:

The attached letter to Chairman Pickle responds to a number of questions raised about the YMCA at the Oversight Subcommittee's recent hearings on the unrelated business income tax. YMCAs welcome Congress' interest in our operations. We believe that we earn our tax exemption each day, as we have for over a century, through our broad range of community service programs. If you have continuing questions about any aspect of our operations, we sincerely hope that you will give us the opportunity to respond.

Sincerely,

Bob Boisture

Robert A. Boisture, Director
Washington Office

James W. Ashley
Chairman, National Board

Solon B. Cousins
National Executive Director

YMCA of the USA
Washington Office
1030-15th Street, N.W.
Suite 976
Washington, D.C. 20005

(202) 898-0160

July 31, 1987

The Honorable J. J. Pickle
U. S. House of Representatives
Washington, D.C. 20515

Dear Congressman Pickle:

The YMCA very much appreciated the opportunity to testify at the recent unrelated business income tax hearings before the Oversight Subcommittee. This letter responds to some of the questions raised by you and other subcommittee members in somewhat more depth than was possible at the hearings. The YMCA welcomes the subcommittee's interest in our programs, and stand ready to provide whatever additional information you feel would be helpful to your inquiry.

1. What is the YMCA's policy on persons who want to use YMCA facilities but who cannot afford established membership and/or program fees?

As stated by YMCA witnesses at the UBIT hearings, virtually all local YMCAs have a policy of providing free or reduced cost memberships to all persons, youth and adults, who could not otherwise afford to participate. To provide the Oversight Subcommittee with more detailed information on these policies, the YMCA of the USA staff has conducted a telephone survey of a random sample of 162 YMCAs. (The sample constitutes 17% of all YMCAs).

It is important to point out at the beginning that the financial assistance policies described below are only part of YMCAs' overall practices that insure that their programs and services are accessible to all persons in the communities they serve. Even more important is the fact that YMCAs establish their basic membership and program fees at levels that are affordable to the great majority of persons in the community. The average adult membership fee is $272 -- less than 75 cents per day. YMCAs' experience suggests that for low income persons who place a priority on fitness and regular exercise, fees of this magnitude are generally not a barrier to participation. To keep their memberships and programs affordable, YMCAs often price them substantially below the cost of delivering the services in question, funding the balance of the costs through charitable contributions. For example, virtually all YMCA youth memberships and programs are priced substantially below cost. Likewise, in the case of metropolitan YMCAs operating branches throughout their

James W. [illegible]
Chairman, National Board

Solon B. Cousins
National Executive Director

communities, membership and program fees at branches serving low-income communities are often set below cost in order to make them affordable to the communities served. Every person using those facilities is, in effect, receiving financial assistance from the YMCA.

The telephone survey did not attempt to collect information on this broader aspect of YMCA pricing policies, but focused, instead, on the narrower question of how YMCAs respond to individuals who cannot afford established YMCA membership and program fees.

The survey indicates that 100% of the YMCAs surveyed allow children and youth from low income families to participate in YMCA programs free or at substantially reduced cost. To the extent of YMCAs' financial resources, no youth is ever denied the right to participate because of inability to pay.

92% of the YMCAs surveyed have a similar policy for adults. While the details of these financial assistance policies for adults vary significantly among local YMCAs, the survey responses indicate that local YMCAs typically use a sliding scale approach under which the amount of subsidy given to a particular individual is based on an overall assessment of that person's need, taking into account such factors as family income and family size.

76% of the YMCAs surveyed routinely publicize the availability of financial assistance in their program brochures and other promotional materials, which are widely distributed by the YMCA in the community. Other YMCAs use paid advertisements or announcements in the public press (31%) and/or referrals from churches and social services agencies (41%) to inform needy persons that financial assistance is available.

97% of the surveyed YMCAs with financial assistance policies for adults stated that an adult who receives a free or reduced cost membership gets a full privilege general adult membership. Such a general membership typically provides access to all of the YMCA's major fitness facilities, including the pool, gym, weight rooms, and track. At a significant number of YMCAs surveyed, adult members may pay an additional fee over and above the general membership fee for the use of a separate locker and steamroom facility, and in some cases general members must also pay an additional fee for the use of certain exercise equipment. The special locker room and equipment are generally not made available on a subsidized basis to adults receiving subsidized general memberships.

At the hearings, several questions were raised specifically concerning the financial assistance policies of the National Capital YMCA located in downtown Washington. The National Capital YMCA has three categories of heavily subsidized memberships that make its programs and facilities accessible to persons unable to pay its general membership fees. First, 456 memberships are set aside for persons with annual incomes under $14,000. Second, 216 memberships are set aside for young people age 18-21 and retired persons over age 64. Finally, the YMCA provides 127 memberships for low-income senior citizens for whom the YMCA also provides free transportation to the downtown facility. These three categories comprise 13% of the National Capital YMCA's total members, and insure that the YMCA is accessible to all income levels in the Washington community. This fact was confirmed by a recent survey of the YMCA's members, which shows that the income composition of the YMCA's members almost precisely mirrors that of the Washington metropolitan area as a whole.

2. Are YMCAs concentrating their new investment in affluent communities, and reducing their service to low-income communities?

No. A June 1987 study by the YMCA of the USA Research Department indicates that of the 62 new YMCAs established since the beginning of 1985, 42% are located in and serve communities in which the median household income is below the national average. The commitment to serve low-income communities reflected in these national data is equally apparent in the capital investment budgets of major YMCAs around the country. For example, the Philadelphia YMCA has invested $7 million in inner-city facilities in the last five years. The Los Angeles YMCA recently opened a $5.5 million program center in the heart of Watts and plans another $2.5 million facility in a poor Hispanic community in East Los Angeles. The Chicago YMCA invested $8 million in its New City YMCA serving the low-income Cabrini Green community, and is building a $9 million facility in the impoverished southside community of Woodlawn. The Washington, D.C. YMCA's board has just approved a capital campaign for a new $5 to 6 million center serving inner-city youth. The list could go on, but the point is clear. Unlike commercial health clubs, YMCAs are committed to serving the whole community.

3. Who determines where to establish a new YMCA?

There are two basic patterns -- neither of which involves the national YMCA taking the initiative in deciding where to locate new YMCAs. In communities that are not in close proximity to an existing YMCA, the impetus for establishing a new YMCA generally comes from a group of citizens who have been involved with YMCAs in other communities. Typically, this citizens group will contact the YMCA of the USA for information about establishing a YMCA. The YMCA of the USA will then send a consultant to meet with the local group to help them assess whether their community can support a successful YMCA. If this evaluation indicates that it is feasible to establish a YMCA, YMCA of the USA staff will then provide detailed advice on program development, fundraising, and other issues related to the successful operation of the YMCA. While the YMCA of the USA provides this in-kind support at no charge, the YMCA of the USA does not make a direct financial contribution to establish a new YMCA. The necessary funds to establish YMCA programs, and, ultimately, to construct a YMCA facility, are raised in the local community.

In a metropolitan area already served by a YMCA, the events leading to the establishment of a new YMCA branch follow a somewhat different pattern. The board and staff of the metropolitan YMCA, in consultation with citizens groups and other interested parties, generally take the initiative in identifying areas of the community that need and can support YMCA programs and/or a YMCA facility. Funding for the new facilities generally comes from a community-wide fundraising campaign. YMCA of the USA staff provide advice and counsel on an as needed basis.

4. Do YMCAs monitor commercial health clubs to identify successful programs that YMCAs can then offer in competition with commercial clubs?

No. The idea that YMCAs copy financailly successful programs of for-profit health clubs has no basis in fact. On the contrary, commercial health clubs have built on the solid foundation laid by YMCA fitness programs, not vice versa. YMCAs have been recognized as the pioneers in the development and the delivery of quality community fitness programs for more than a century. Many YMCA programs, for example, the Y's Way to Fitness and the Y's Way to a Healthy Back, have become benchmarks for quality in the fitness field. Similarily, the YMCA pioneered the development of a standardized national system for training and certification of fitness instructors. Many of the fitness staff at commercial health clubs received their training through the YMCA system. As the president of the American College on Sports Medicine stated in 1983, "YMCAs are without question the leading provider of quality community fitness programs in America today."

Virtually all new YMCA programs are initially developed by particular local YMCAs, based on their experience and perceptions of community need. The more successful local programs are then replicated throughout the YMCA system. The principal function of the YMCA of the USA's program staff is to identify successful local YMCA program innovations, work with local YMCA program staff and outside experts to refine the program design, and then facilitate replication of these programs throughout the YMCA system. The YMCA of the USA's program development priorities for 1987 are in the fields of fitness for senior citizens, youth health, workplace fitness, and child care.

Neither the YMCA of the USA, nor, to the best of our knowledge, any local YMCA, monitors commercial health clubs or other for-profit businesses to identify successful programs for use by YMCAs. Indeed, YMCA of the USA program experts frequently find themselves cautioning local YMCAs against practices common in commercial health clubs. For example, based on an evaluation by our Medical Advisory Committee, the YMCA of the USA recently issued a strong warning against the use of tanning beds, a prominent feature of many commercial health clubs.

5. What is the relationship between local YMCAs and the national YMCA organization?

The are approximately 970 independent local YMCAs in the United States, operating approximately 2,000 YMCA branch facilities. Each local YMCA is controlled by a board of local volunteers. Each of the 970 local YMCAs operates as an independent economic unit.

Local YMCAs have joined together in a national movement through their membership in the National Council of Young Men's Christian Associations. As a requirement of membership in the National Council, local YMCAs pay annual dues equal to approximately 2% of their gross revenues. The YMCA of the USA has a staff of approximately 200 and an annual budget of approximately $25 million. Services provided by the YMCA of the USA to local YMCAs, as well as the organizational structure through which these services are provided, are described in the attached brochure entitled "YMCA of the USA...Leadership and Service."

6. Can communities rely on commercial health clubs to meet community fitness needs traditionally served by YMCAs?

YMCAs serve their communities in many ways commercial health clubs never will. As described above, through financial assistance policies and below-cost pricing of many programs, YMCAs serve many persons who cannot be served at a profit. A further key difference between YMCAs and commercial health clubs concerns quality and reliability of services. While there are many reputable commercial health clubs, the industry as a whole has a well documented history of "fitness" fads, consumer fraud, high pressure sales tactics and bankruptcy. National Council of Better Business Bureau data ranking industry groups in order of frequency of consumer complaints show commercial health clubs moving from number 50 in 1979 to number 20 in 1984, the last year for which the Bureau published this data. A Federal Trade Commission report released in 1984 catalogued a broad range of consumer complaints against commercial health clubs, including misrepresentation of contract terms, high pressure sales tactics, misrepresentation of facilities, bait advertising, and closing of facilities without refund. State attorney generals and state consumer protection agencies also report numerous complaints against commercial clubs. For example, in 1984, the Florida Department of Agriculture and Consumer Services received 2,436 consumer complaints against health clubs, 16.5% of all complaints. In response to such complaints, 27 states have enacted legislation specifically regulating commercial health clubs. However, a recent Wall Street Journal article (copy attached) concludes that "in many cases...legislation is proving ineffectual because the clubs are easy to open and their sheer numbers make them hard to police. Prosecution for abuses also is often difficult. As a result sudden closings continue to leave many members in the lurch and complaints persist about high pressure sales tactics and false advertising." Wall Street Journal, Friday, April 3, 1987.

By contrast, no state has ever enacted legislation to protect its citizens from the YMCA. For over a century, YMCAs have demonstrated that they are a reliable, effective instrument for advancing the public interest in providing quality community fitness programs.

Conclusion

YMCAs welcome the subcommittee's interest in our operations. We believe that we earn our tax-exemption each day, as we have for over a century, through our broad range of community service programs. If you have continuing questions about any aspect of our operations, we sincerely hope you will give us the opportunity to respond.

Sincerely,

Bob Boisture

Robert A. Boisture
Director, Washington Office

Attachments

THE WALL STREET JOURNAL, FRIDAY, APRIL 3, 1987

Fiscal Fitness: Efforts to Regulate Health Clubs Fail to End Abuses

YOUR MONEY MATTERS

By RICHARD B. SCHMITT

Staff Reporter of THE WALL STREET JOURNAL

Two years ago the Beverly Hills Workout, a Santa Monica, Calif., health club, drew a fast crowd when it began selling $49 annual memberships.

But within weeks after the promotional drive began, the four-year-old club was gone and the owners of its parent company, On the Move Inc., were moving on to bankruptcy court. Several hundred people lost a total of $65,000, and the building was converted into a dry-cleaning business.

Scores of similar failures, along with a wide array of operating problems, have focused growing regulatory attention on the health-club industry. And the crackdown seems to be helping—somewhat.

In many cases, for instance, legislation is proving ineffectual because the clubs are easy to open and their sheer number makes them hard to police. Prosecution for abuses also is often difficult. As a result, sudden closings continue to leave many members in the lurch, and complaints persist about high-pressure sales tactics and false advertising.

"Overall, the situation may be improving," says Phil Gibson, an assistant state attorney general in Missouri. "But then again, it couldn't get much worse." Adds Isobel Murray, a former prosecutor for Santa Barbara, Calif.: "Health clubs have become a wonderful way for people with very little capital to defraud the small consumer out of millions of dollars."

Fewer Frauds?

Not everyone agrees that the industry's problems are so widespread, and certainly many clubs are legitimate. Even some health-club critics concede that there are now fewer examples of outright fraud than there were several years ago.

Moreover, in 1985, the Federal Trade Commission decided against issuing federal rules for health spas, questioning the pervasiveness of fraud and other abuses. Terry Calvani, acting chairman of the commission at the time, was also concerned that a law enabling consumers to get refunds more easily would "make the spa business less attractive to investors."

The states, though, have taken action. Some 27 of them currently have health-club laws, compared with 17 in 1983. Increasingly, they are requiring clubs to post bonds to cover potential losses and to stop selling "lifetime" memberships, because members have often proved more enduring than the clubs themselves. Connecticut collects a registration fee from the clubs that is used to reimburse victims in fraud cases. Last year, Maryland named a health spa commissioner to enforce the state's regulations.

One source of trouble is the way many health clubs are financed. Little capital is needed because the equipment and real estate are often leased. Operators rely mainly on fees from new members for cash flow, and some people are unwittingly enlisted after financial troubles emerge. In a pending suit filed in Jackson County Circuit Court at Kansas City, the state of Missouri claimed that International Fitness Centers, a Kansas City-area chain, sold memberships while creditors were foreclosing on defaulted loans. The club declined to comment on the charge.

The system can also doom older clubs. Sportrooms, a seven-year-old Coral Gables, Fla., club, failed in February because it couldn't attract enough new prospects. Its roughly 5,000 members are likely to lose a total of several hundred thousand dollars, says Ronald Neiwirth, an attorney for the club, which is seeking bankruptcy protection. "Health clubs live and die by selling memberships," he explains. "It's a generic problem."

Hand-to-mouth financing also creates intense pressure on salesmen, which they sometimes turn on potential members. For example, Washington state's Family Fitness Centers, operated by Traveler's Financial Services Inc., used "coercion, intimidation or severe embarrassment" to get people to join, the state charged in a 1983 lawsuit filed in the state superior court for King County. The clubs allegedly tried to break down stubborn customers by subjecting them to hour-long sales pitches in crowded offices, posing such questions as "Do you really want to look like that for the rest of your life?"

> **ONE HEALTH-CLUB chain allegedly tricked people into signing binding membership contracts; it then turned the contracts over to collection agencies.**

The clubs also tricked people into signing binding membership contracts, according to the suit, giving them the impression that they were merely filling out applications. The contracts were then allegedly turned over to collection agencies.

Family Fitness, without admitting or denying guilt, settled the charges by refunding about $500,000 to disgruntled members. Last May the state sued again in the same court, citing the same practices, and the club agreed to give back $600,000 more. But not all the money has been paid, and a full recovery appears remote because the club has gone out of business. Club officials couldn't be reached for comment.

Prosecutors and consumer activists in several states say clubs also frequently misrepresent the benefits of belonging to the International Physical Fitness Association, a 2,000-member Flint, Mich., trade group whose clubs extend reciprocal privileges to individual members.

Some IPFA member clubs use the affiliation to assure customers that if they move they will be able to use hundreds of other facilities nationwide for free or for a small cost. For example, a recent ad for 24-Hour Nautilus Fitness Centers touted seven locations in northern California "plus 2,000 worldwide . . . and still growing!" But the club owns only the seven, the rest being IPFA members. Leonard Schlemm, the club's chairman, defends the assertion but says he plans to clarify the distinction in the future.

According to IPFA rules, member clubs have to honor the old membership contracts for two years at most, but less if they should come renewable. After that, members must negotiate new contracts, which often carry new initiation fees. Members may also face regular "facility" or "maintenance" charges that their old clubs didn't have.

"There is a real question whether the IPFA is policing its own members," says Karl Boettner, an assistant state attorney general in Washington.

The group, however, claims that that isn't its responsibility. "When things happen with the clubs, that is between the member and the club," says Shelly Rhoades, an IPFA manager in Flint. "All we are is a transfer organization. We have nothing to do with how a club is run."

Another common complaint is that clubs pressure customers into making quick decisions about discounts that, in reality, aren't discounts at all.

Special Deals

Pacific West Sport and Racquet Club, which succeeded Family Fitness as Washington's biggest club chain, advertised discounts of up to 45% to first-time visitors, who were also told that enrollments would be limited, according to a suit brought by the state last fall in the King County Superior Court charging unfair and deceptive business practices. However, the suit alleged, hardly anyone ever paid more than the discounted prices, and the membership limits were a fiction.

Neither admitting nor denying guilt, Pacific West agreed to refund up to $750,000. The club asserts that the complaints were isolated and that it has taken steps to resolve any problems.

Although regulation of the industry has increased, prosecution of operators is rare because intent to commit fraud must be proved in court, and intent is notoriously hard to establish. If nothing else, owners can argue that they were simply bad or unlucky managers. Moreover, even the new laws sometimes have loopholes. Florida's new bonding requirement, for example, didn't apply in the case of Sportrooms because the club had been open for more than three years.

Says Kathleen Curry, chief of consumer affairs for the Connecticut Department of Consumer Protection, "There is no silver bullet that is going to eliminate this problem."

YMCA of the USA

. . . . LEADERSHIP AND SERVICE

(A quick reference to local YMCA support
and the YMCA governance system)

**Six Methods of Service Available to All YMCAs
Coordinated Through
National Field Offices and Headquarters**

Field Consultants
Local "Y"
Headquarters Staff
Outside Consultants
MRC's
Local Consultants
Clusters

- **Field Consultants**
- **Headquarters Staff**
- **MRC's**
- **Local "Y" Consultants**
- **Kindred Clusters**
- **Outside Consultants**

The YMCA of the USA, headquartered in Chicago, provides direct services to member YMCAs and gives leadership nationally on their behalf. Services are extended through five National Field Offices. In addition to giving management and program assistance, Field Office staff provides support to Clusters (small groups of Ys located close to each other) and maintains the system of membership standards.

The national service system is decentralized, enabling resources to be deployed from any part of the country to any other. This is done in person or by phone between national staff and member associations. Service also is given through contract agreements between a YMCA requesting assistance and someone who is a recognized resource in the national system. The consultant could be a professional staff person from within the Y movement, an outside consultant, a volunteer from a Cluster, or another expert from a kindred group. It could be a team, depending on the size and nature of the issue at hand. Special services include assistance in starting a new YMCA, help for a troubled association, and a resource person specifically for small-to-midsized YMCAs.

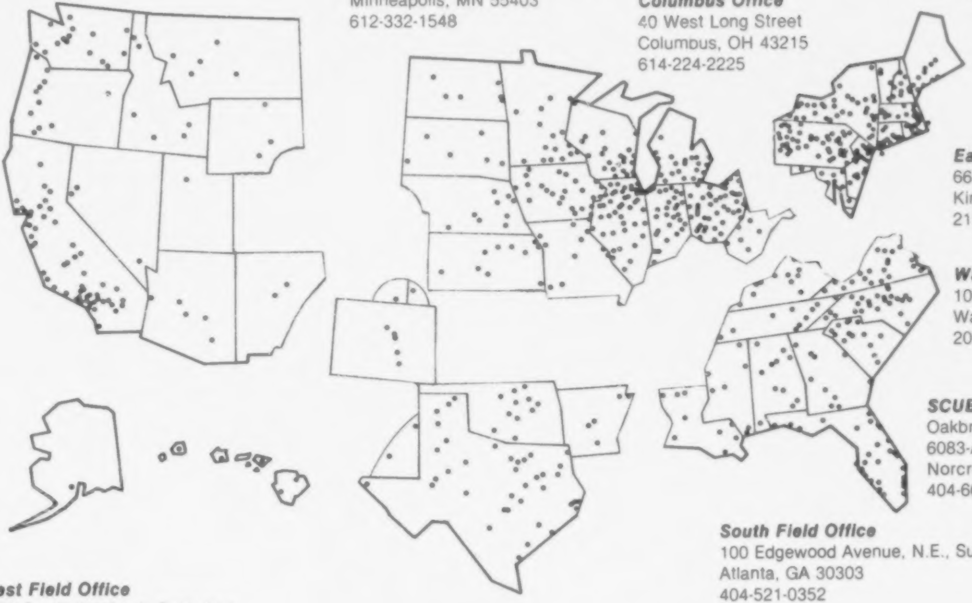
In addition, Management Resource Centers (MRCs) offer management and program assistance. National headquarters contracts with YMCAs located in large metropolitan areas to provide these services to independent YMCAs nearby.

Your first point of contact for information or service is the Field Office or MRC. You may also call national headquarters at 1-800-USA-YMCA, depending on the questions you have and the subject of your concern.

Solon B. Cousins

Solon B. Cousins
National Executive Director
YMCA of the USA

FIELD OFFICES (Direct Service to YMCAs)



Portland Office
514 SW 6th Avenue
Portland, OR 97204
503-223-9622

Midwest Field Office
730 Hennepin Avenue, Suite 820
Minneapolis, MN 55403
612-332-1548

Columbus Office
40 West Long Street
Columbus, OH 43215
614-224-2225

Special Services
10206 Berkshire Road
Bloomington, MN 55437
612-835-3138

East Field Office
661 Moore Road, Suite 120
King of Prussia, PA 19406
215-337-3116

Washington Office
1030 15th Street, NW, Suite 976
Washington, DC 20005
202-898-0160

SCUBA Program
Oakbrook Square
6083-A Oakbrook Parkway
Norcross, GA 30092
404-662-5172

South Field Office
100 Edgewood Avenue, N.E., Suite 1230
Atlanta, GA 30303
404-521-0352

West Field Office
1650 South Amphlett, Suite 314
San Mateo, CA 94402
415-574-2003

Southwest Field Office
Mockingbird Towers, Suite 900-E
1341 West Mockingbird Lane
Dallas, TX 75247
214-630-4796

The Program Store
Box 5077
Champaign, IL 61820
217-351-5077

Midsize and Smaller Associations
Rockford YMCA
200 Y Boulevard
Rockford, IL 61107
815-987-2995

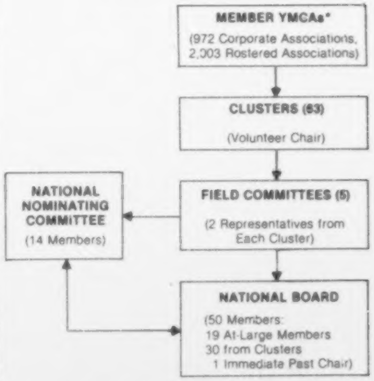
. . . . LEADERSHIP AND SERVICE

YMCA of the USA

COMPONENT	HOW FORMED	MEMBERSHIP	AGENDA	RELATIONSHIP TO OTHER COMPONENTS	ADDITIONAL FUNCTIONS	COMMENTS
Rostered YMCAs (Branches & Corporate) (2,003)	-Authorized by Corporate Y's	-Local Decision	-Community Service -Association Issues	-Responsible To Parent (Corporate) Member YMCA		-Member (Incorporated) YMCAs Plus Branches -Staff: Local
MEMBER YMCAs (Corporate) (972)	-Locally Incorporated Within State	-Local Decision	-Association & Corporate Issues ☆ -Votes On Constitutional Changes By Mail	-Responsible For Rostered Assns. Related to Member YMCA -Member Assn. Of YMCA of the USA (Pay Dues)	-Extension In Its Service Area	-Member YMCAs Are Incorporated YMCAs -Staff: Local
CLUSTERS (63)	-Geographic Grouping by Local and National Agreement	-Corporate Y CVO, CEO Plus 1 Vol. from Each Rostered Association -Members Chosen By Associations & Corporations	-Governance -Association Issues -Program Exchange -Fellowship	-Serves As Forum for Geographic Group of Associations -Cluster Chair and One Additional Member Serve on Field Committee	-Elects Cluster Officers	☆ -KEY LEVEL OF LAY INVOLVEMENT (other than local) -Staff: MRC, Field, National
FIELD COMMITTEES OF NATIONAL BOARD (5)	-Natural Grouping As Determined By National -Functions As A Committee of National Board	-2 Representatives from Each Cluster	-Governance -Association Issues -Certification -Standards -Extension -Fair Share Program -Evaluation -Meets 2 times per year	-A Committee Of The National Board	-Elects Field Committee Officers	-Shall Try To Maintain Ratio of 4 Volunteers to 1 Staff On The National Board -Staff: National
NATIONAL BOARD (1)	-Incorporated, With Constitution & Bylaws -Members Elected By National Board From Candidates Submitted By the National Nominating Committee	-50 (Including 5 Field Committee Chairs)	-National Policy -Allocation Of Resources -Administer Trusts, Hold Property -Meets 2 times per year	☆ -Appoints Members of Standing National Committees (Including Nominating Committee and Committee for Standards & Extension)	☆ -Elects The National Officers & Adopts Bylaws	50 Members, 30 nominated by Field Committees, 19 At Large, Past Chair of National Board -Staff: National
NATIONAL ASSEMBLY (1)	-Authorized By Constitution	-Members of National Board and Field Committees	-National Council Operations, Percentage Support, Constitutional Amendments -Meets every 2 years	-Directly Involves Field Committees and National Board		-Staff: National
GENERAL ASSEMBLY OF YMCAs	-Authorized By Constitution & Bylaws	-Member and Rostered YMCAs Eligible to Send Such Representatives As They Choose and Finance -Field Committees -National Board	-Non-legislative Functions -Program Exchange -Fellowship -Inspiration -Mission -Meets Every 5 Years (approximately)	-Involves All Components: Rostered and Member YMCAs Field Committees National Board		Allied YMCA Groups Invited To Attend -Staff: National

3/25/87

YMCA GOVERNANCE



***The Power to Amend the Constitution and Change the Financial Support Formula Resides Solely with Member Associations.**

Term	Definition
BRANCH	A subordinate unit of an incorporated member YMCA
CEO	The Chief Executive Officer (Staff) of an incorporated YMCA
CVO	The Chief Volunteer Officer of an Incorporated YMCA
CLUSTER	A geographic grouping of incorporated YMCAs, part of the governance structure
FIELD COMMITTEE	The governance link between specified Clusters and the National Board
MRC	A corporate YMCA under contract with the National Board to provide services to assigned member Associations
MEMBER ASSOCIATION	An incorporated YMCA which meets membership criteria
ROSTERED YMCA	Member Associations and their branches
YMCA of the USA	The national federation of the U.S. YMCAs, legally incorporated as the National Council of Young Men's Christian Associations of the United States of America

. . . LOCAL YMCA DUES (Percentage Support)

HELPS PROVIDE THESE SERVICES TO YMCAs

TRAINING AND CERTIFICATION

Opportunities for continuing education and certification in YMCA work are offered at the **National Development Center** and at sites throughout the country. Certification programs include the Career Development Program for professional recognition, and certification of instructors in specific program areas. Training programs include, but are not limited to, Advanced Management institutes, Financial Development institutes, management, tax issues, computers, personnel, and public relations, and program workshops on corporate health enhancement, school age child care, youth sports, family programming, health and physical education, teen programs, aquatics, and camping.

PERSONNEL SERVICES

The selection of a YMCA executive is a key decision for the board of directors and its search committee. National staff can help you in that selection as well as secure applicants from throughout the country for other vacant positions. Additional assistance can be given in establishing a salary administration plan, personnel policies, employee benefits, and equal opportunity and affirmative action plans.

PROGRAM DEVELOPMENT AND DISCOVERY

New YMCA programs are continually being developed to meet changing community needs. Through program networks, national conferences, task forces, and publications, local programs are discovered and program models developed. Program themes currently being emphasized are health enhancement, family strengthening, leadership development, international understanding, and community development.

LEGAL COUNSEL

From tax issues to interpretation of the law, legal advice and consultation are available to your YMCA. Awareness of current trends in tax challenges and court decisions plus knowledge of what other YMCAs already have experienced benefit you in effectively operating your YMCA.

LEGISLATION

Federal legislation related to youth employment, child care, delinquency prevention, health, charitable contributions, and tax issues is monitored for implications to YMCAs. Interpretation and information on these issues are published in newsletters titled "Capitol Briefs" and "Tax Newsletter."

YMCA SOFTWARE

Computer software packages designed specifically for YMCA operations are available at a very small cost to YMCAs. An example is Y-Ware—a software package especially for small YMCAs.

YMCA RETIREMENT FUND

Through membership in the YMCA of the USA, employees have an opportunity to invest in the YMCA Retirement Fund, a plan offering extraordinary benefits to its members.

USE OF YMCA NAME AND SYMBOL

You are entitled to trademark use and protection as a member of the YMCA of the USA. Recent studies verify high recognition of the YMCA name and highly favorable attitudes toward the organization. Use of the name and symbol help you garner community support and program participation.

JOINT INSURANCE PLAN

Member YMCAs can join with other YMCAs in purchasing many kinds of insurance. Plans are offered at favorable rates that help YMCAs contain costs while protecting their associations against risk thru Y-Mutual.

JOINT PURCHASING

Reduced prices for equipment and supplies are given by vendors participating in the national purchasing program. Volume discounts help YMCAs get the most for their money in quality products and services while dealing directly with the vendors.

THE PROGRAM STORE

Hundreds of items for running and promoting YMCA programs are available through The Program Store. It has everything from the latest in how-to manuals and handbooks to program materials such as headbands, patches, and certificates. Publications on programs and management practices are continually being developed and revised so that Y staffs have the latest information on running their associations and programs.

RESEARCH AND EVALUATION

Surveys and studies are conducted to collect pertinent information of interest to YMCAs. Examples are constituent and non-constituent studies, YMCA statistics and analysis, YMCA management evaluations, program evaluations, fee and payment option studies, and U.S. Census data analysis.

TROUBLED ASSOCIATIONS

Sometimes YMCAs find themselves in situations that threaten their survival. When this occurs, assistance is available to analyze the situation and develop a strategy for returning the YMCA to full effectiveness.

STARTING NEW YMCAs

The extension of YMCAs is important to the growth of the YMCA movement. Services are offered to show community leaders how to proceed and to give support at each point in their decision making.

PUBLICATIONS

Numerous publications are given to YMCA staff and volunteers to keep them abreast of current ideas, issues, and interests. These include a bimonthly magazine titled *Discovery*, YMCA Executive Notes, Y Notes from the Field, Program Notes, YMCA Directory of Associations and Staff, National Vacancy List, and YMCA of the USA Annual Report.

MARKETING AND COMMUNICATIONS

Advertising campaigns for placement in the print and broadcast media are available to promote your YMCA and its programs. Assistance also is available on subjects such as marketing management, promotional strategies, and public relations techniques, including working with the news media. A variety of print and audio-visual materials is produced to help you establish a positive image for your YMCA.

FINANCIAL DEVELOPMENT

Networks of experienced YMCA staff offer assistance in cost studies, fiscal management, pricing memberships and programs, identifying new income sources, and fund raising. Services include practical advice and even assigning personnel to help in endowment development, sustaining membership campaigns, and capital campaigns, while generally tracking trends in financial development and YMCA income sources.

PLANNING

Planning assistance for YMCAs of all sizes and complexity are available. Review of Mission, environmental scanning, issues identification and formation of action steps are areas wherein consultation is readily "on call."

INTERNATIONAL SERVICES

The family of YMCAs extends beyond the USA to nearly 90 countries around the world. In an effort to increase understanding, international programs help you to link up with a YMCA in another part of the world and eventually become partners. The U.S. national office coordinates with national offices abroad.

BUILDING AND FURNISHINGS SERVICE

Consultation on architectural and interior design of new and renovated facilities offers YMCAs the latest in technological innovations and building design.

MANAGEMENT CONCERNS

Consultation is available on such subjects as board recruitment and development, policy development and review, facility and property management, fiscal management, membership policies, and corporate planning.

CAMPAIGN ASSOCIATES

Consultation on Capital Campaigns Endowment Development and Annual Support Campaigns, provides presentations for Workshops and Seminars.

YMCAs UNDER $1.0 MILLION

Special attention is available for YMCAs with budgets under $1.0 million. A Field Executive represents their interests and responds to their needs in the delivery of national services.

. . . LEADERSHIP AND SERVICE

YMCA of the USA

The YMCA of the USA National Service System supports 2,003 local YMCAs having combined operating budgets in excess of $1 Billion.

The YMCA of the USA maintains a staff of approximately 200 and operates with a budget of $25 Million. Its National Office is in Chicago; there are 5 Field Offices, 2 Area Offices and the National Development Center (Rosemont, IL near O'Hare Airport).

3/25/87

National Development Center
6400 Shafer Court
Rosemont, Illinois 60018
312-823-2895
800-872-9622

National Offices:
101 North Wacker Drive
Chicago, Illinois 60606
312-977-0031
800-872-9622

Mr. DORGAN [presiding]. Does the gentleman yield back the balance of his time?

Thank you very much.

The Chair would like to thank very much the first panel of the morning. We think that your testimony has been very useful. We appreciate your patience in answering the questions. And thank you for being here.

Your entire statements will be made a part of the record.

Next we will hear the second panel of the National School Boards Association, Jonathan Howe, president; the Texas Hearing Aid Association, Ray Jones, member of the legislative task force; the American Speech-Language-Hearing Association, Patricia R. Cole, Ph.D., president, Austin, Tex.; Structure Probe, Inc., Charles Garber, Ph.D., president; the Subsurface Library, Kingdon R. Hughes, owner, Midland, Tex.; Fiscal Planning Services, Stuart Rabinowitz, president; National Association of Portable X-Ray Providers, Frank Gambardella, president.

We would ask that these panel members please come forward and take your seats.

Mr. SCHULZE. Mr. Chairman, if I may, I would like to welcome Dr. Garber, who is both a constituent and an old friend, whom I have known close to 20 years. I welcome him in his first time testifying before the Ways and Means Committee.

We are graced with your presence, Chuck.

Chairman PICKLE. While they are getting seated, Mr. Chairman, I also want to recognize Mr. Ray Jones, member of the legislative task force from the Texas Hearing Aid Association. Welcome Mr. Jones.

And then we have from Austin, Patricia Cole. Dr. Cole is president of the American Speech-Language-Hearing Association. Dr. Cole, welcome.

And we have from Midland, Tex., Mr. Kingdon Hughes representing the Subsurface Library. Where is Mr. Hughes? Yes. Glad to have you Texas people here.

Mr. DORGAN. The Chair thanks the panel for being with us today. I would like the audience to please take seats. The committee will be in order.

First we will call on Jonathan Howe, president of the National School Boards Association.

STATEMENT OF JONATHAN T. HOWE, PRESIDENT, NATIONAL SCHOOL BOARDS ASSOCIATION

Mr. HOWE. Thank you, Mr. Chairman.

I am Jonathan Howe, president of the National School Boards Association.

Mr. DORGAN. Mr. Howe, might I say that your entire statements will be made a part of the record, and we would ask you to summarize.

Mr. HOWE. I understand. That is what I am going to do, sir.

Mr. DORGAN. Thank you.

Mr. HOWE. I serve as a school board member in Northbrook, Ill. I am also a lawyer in Chicago who specializes in the area of representation of not-for-profit tax-exempt organizations, primarily trade associations, professional societies, and other organizations.

The National School Boards Association is delighted to have this opportunity to appear before this committee to outline the nature and scope of income producing activities undertaken by National and State school board associations, and why we believe it would be inappropriate to change the law at this time so as to impose any kind of Federal income tax upon such organizations.

The National School Boards Association is the only national education association representing the 95,000 local elected school board members who in turn have the responsibility for governing some 16,000 school districts across this country.

The National School Boards Association is a federation representing 49 State school board associations, and the boards of education of Hawaii, the District of Columbia, and the U.S. Virgin Islands.

The Nation's States and national school boards associations were created by local elected school board members responsible for the governance, operation and management of these local public school districts. In most cases, such State associations are specifically authorized by State statute, as in the case of Illinois from where I come.

In turn, membership in the governance of State and National school boards associations is restricted to sitting local school board members, such as myself. The tax-exempt purpose of the State and National School Boards Associations is the support and advancement of local public elementary and secondary schools.

In the narrowest sense, that purpose is at all times subservient to the larger purpose of the governmental entity the association was initially created to serve. In the broadest sense, that purpose is legally incapable of expanding beyond activities other than to lessen the burdens of units of local government. In that regard, no activity undertaken by a State School Board Association extends direct benefit, either monetary or other, to the local elected school board officials who are the members of the local units of government.

Many State school board associations engage in two primary activities which generate unrelated business income. First, they may have rental of debt financed real property. Second, advertising income generated through advertising appearing in their publications.

In many cases the income produced from these activities exceeds 10 percent of the total gross income of any State association.

I might also note that associations generating such income have a lessening of total income coming from dues. All other income generated by State associations is related to the exempt purposes of the organization. That includes dues income, income received from conventions and expositions, conferences and workshops, the provision of professional services and policy services to local school districts, curriculum programs, and other materials, and because of some of the problems that we have all faced, State school board associations have had to involve themselves in the provision of alternatives to liability insurance.

The average annual gross income of the State school boards association is between a half a million to three-quarters of a million. Some of our associations are as low as $200,000; others may exceed $4 million in income.

From whatever source derived, all income generated by the National and State school boards association is employed in furtherance of the tax-exempt purpose of these associations. Expansion of the current code definition of unrelated business income to include even one of the currently exempt activities carried on by these associations would, we submit, have no positive impact whatsoever on Federal revenues and could in fact reduce or impede competition and the availability of the so-called for-profit industry to service school districts.

First, imposition of the corporate tax, or an income tax on goods and services offered by these associations, would necessarily increase costs to local school districts. The result of these additional costs is an increase in the deductible State income and local property taxes. Thus, what the Federal Government may gain by imposition of a corporate income tax on a particular good or service offered by State school boards association would be lost through a corresponding increase in taxpayer deductions.

Second, a political determination by a local school board to refrain from imposing additional taxes through increases in real estate taxes on their constituencies in order to meet the burden of additional costs which may relate to services provided by State school board associations which are now taxable to them and, thus, costing more would only result in one basic situation. That is, the school district would be forced to internally assume the increased financial burden and thereby simultaneously reduce other components with the school district program, thereby reducing the expenditures they would be making to taxable vendors.

The response to the many and the technically varied noneducational Federal mandates imposed on local school districts—goods and services traditionally offered by State school board associations—have necessarily been expanded to include activities crafted to reduce the increased burdens visited on local school districts and the taxpayers they serve.

The majority of local school districts are financially incapable of unilaterally assuming the high cost of the type and quality of technical personnel required to develop and manage federally imposed noneducational programs.

An example of that, gentlemen, would be asbestos removal from the public schools.

Moreover, imposition of each new unfunded Federal mandate further erodes the availability of the small sums that local districts once earmarked for development and implementation of innovative plots from techniques, particularly in the ever-changing areas of math and science and high tech.

If a level playing field is a condition precedent in determining the existence of competition, State school board associations are incapable of competition with the private sector.

First, the range of activities undertaken by State school boards associations expands rather than contracts during periods of economic instability. For-profit enterprises react to the same market fluctuations by reducing the availability of goods or services while increasing the cost of those they continue to offer.

In turn, these actions increase the burden on local school districts, a burden which State school boards associations in fact were created to address.

Second, unlike the private sector, local public schools are unable to shut the door on their business when it becomes unprofitable or undesirable to continue operation. There can be no better example of lessening the demands on Government than facilitating the delivery of a good or service necessary to the prudent operation of a local school system when private industry has withdrawn from the marketplace. Again, the liability insurance situation is a classic example of this.

Finally, National and State school boards associations offer neither goods or services to other units of Federal, State, or local government, or to the private sector. Rather, these associations make their goods and services available only to local school districts.

In summary, the National and State school boards associations thank the committee for this opportunity, and we urge you not to change the law in any way that would impose a Federal income tax on the activities of State school boards associations other than currently in existence through unrelated business income taxation.

We thank you again and, unfortunately, I have to leave. And I will be happy to answer any questions at this time or to respond in writing if that would be the desire of the Committee.

[The prepared statement follows:]

TESTIMONY

on behalf of

THE NATIONAL SCHOOL BOARDS ASSOCIATION

I. INTRODUCTION

The National School Boards Association, representing 49 state school boards associations and the boards of education of Hawaii, the District of Columbia, and the U.S. Virgin Islands, supports this Committee's inquiry into the operation and management of tax-exempt organizations. Moreover, we applaud the efforts of this Committee to ferret out those instances in which unrelated business income is currently being generated by tax-exempt organizations, but has gone untaxed due to ambiguities in current Code definitions or as a result of the failure of tax-exempt organizations to comply with unrelated business income reporting requirements. Finally, not unlike private industry, NSBA believes that activities **unrelated** to a tax-exempt organization's purpose which are in direct competition with services and/or goods of like quality and quantity offered by the private sector should not be shielded from taxation merely because an organization has at some point in time qualified for 501(c) tax-exempt treatment.

However, NSBA also believes that this Committee should not seek to tax those income generating activities intregal to a tax-exempt organization's tax-exempt purpose. In that regard, this Committee should be cognizant of the need to remain sensitive to allegations of competition which are artificial, assuming competition where none exists.

In the case of state school boards associations, the tax-exempt purpose is the support and advancement of local public elementary and secondary schools. Traditionally, the principle purpose of local public schools is the education of the nation's youth. However, experience suggests that the imposition of non-educational Federal mandates has increased to an extent that the latter rivals the former in terms of complexity of administration, personnel, and actual cost to local school districts.

Thus, state school boards associations provide services to local public school districts which are within the scope of a school district's legal responsibility but which, at first blush, appear unconnected to public student education.

II. OVERVIEW: STATE SCHOOL BOARDS ASSOCIATIONS

The nation's state and national school boards associations are incorporated under Code sections 501(c)(1), 501(c)(3), or 501(c)(4). The Articles of Incorporation for each state school boards association provide that the principle purpose of the association is the support and advancement of local public elementary and secondary schools within respective states. Income generated by state school boards associations is continually passed back to local school districts through decreased costs for both goods and services.

State school boards associations participate in a number of income-producing activities. Of these activities, NSBA believes **none is unrelated** to the operation of a local school system or to the tax-exempt purpose of state school boards associations.

A recent survey of state school boards associations revealed that each of the following activities accounted for more than 10 percent of gross annual income: dues, sale of personal services, sale of insurance, annual convention, conferences/workshops, and the sale of copyrighted material.

The average state school boards association reported an annual income of $500,000-$750,000. Over one-half of the survey respondents were aware of a for-profit business which offered the public-at-large a service currently being offered by their state association. In all cases, the state association charge for such service was comparable to or less than that which would be charged by private industry for goods and/or services of comparable worth.

III. AMENDMENT OF THE CURRENT CODE DEFINITION OF UNRELATED BUSINESS INCOME TO INCLUDE THE INCOME PRODUCING ACTIVITIES OF STATE SCHOOL BOARDS ASSOCIATIONS WOULD HAVE NO IMPACT ON FEDERAL REVENUES

State school boards associations generate income from the sale of goods and services to local school districts. Income generated from these sales is passed back to local school districts in the form of discounted costs for the goods and/or services offered. In turn, payment for these items is the taxpayer dollar which funds operation of local public schools.

Expanding the scope of the current Code definition of unrelated business income to include even one of the currently exempted income-producing activities carried on by state school boards associations would necessarily result in an increased cost of goods and/or services to local school districts. The result of additional costs is increased state income and local property taxes.

As the Committee is aware, taxpayers are allowed a corresponding deduction on their federal tax return for the payment of state income and local property taxes, including those allocated to support local public schools.

Thus, expansion of the current Code definition of unrelated business income to include income producing activities undertaken by state school boards associations would generate no federal revenues. What the Federal Government may gain by imposition of the corporate income tax on a particular good and/or service would be lost to the Federal Government through an increase in taxpayer deductions.

Moreover, a political determination by a local school board to refrain from imposing additional taxes on their constituents in order to meet increased costs is capable of only one result. That is, the school district would be forced to internally assume the increased financial burden associated with these goods and services and simultaneously reduce other components of school district programming, thereby reducing expenditures to taxable vendors. In either case, the Federal Government gains no revenues and it is the students who ultimately loose.

IV. FEDERAL MANDATES UNRELATED TO EDUCATION HAVE EXPANDED THE RANGE OF RELATED TECHNICAL INFORMATION AND PERSONAL SERVICES OFFERED BY STATE SCHOOL BOARDS ASSOCIATIONS

While it is true that over the past two decades the various arms of the Federal Government have often been unable to agree on the role state and local governments should play with regard to particular policy issues, this has not been the case with the Federal Government's perception of the role of the local public schools. In that regard, the Federal Government has adopted a unified and consistent appreciation for the ability of local public elementary and secondary schools to implement and deliver broad changes to the national ethos.

For example, in the mid sixties local public elementary and secondary schools were selected as the focal point of racial integration. In the 1970's, local public schools were charged with the financial and programmatical care of the handicapped youth of this nation. In the 1980's, the local public schools have become the testing ground for innovative environmental legislation mandating asbestos removal and worker protection.

It is interesting to note that imposition of these federal imperatives on local school districts was not occasioned by similar enforceable mandates on federal, state, or other local units of government. For instance, the management and actual cost of an affirmative action plan pales in comparison to the complexity of management and actual cost of court ordered busing or court ordered employment practices.

Likewise, while local school districts must assume the full cost and responsibility for education of all handicapped persons ages 3-21 -- including the full cost of non-educational custodial care at residential facilities -- no federal, state, or other local unit of government has offered, nor or they required, to assume responsibility for these persons when they reach the age of majority ... notwithstanding the fact that their incapacity is undiminished.

Finally, federal legislation mandating the containment and/or abatement of asbestos in buildings only applies to primary and secondary schools. It does not extend to federal or state buildings. It does not apply to buildings occupied by other units of local government, including hospitals and penal institutions which provide 24 hour custodial care.

Unfortunately for local school districts, these federal mandates are in addition to, and not in substitution for, what was once the sole responsibility of the local school district; that is, providing a quality public education for all persons age 6-18.

These additional federal demands were visited on the local public schools with federal appropriations totaling less than 10 percent of the overall cost of any one of these programs. Moreover, local school districts, as educational insitutions, were generally unprepared to meet the challenge of these complex and financially burdensome federal requirements absent significant increases to both technical staff and facility capabilities.

In response to the imposition of non-educational federal mandates on local school districts, the traditional role of state school boards associations (central repositories for the dissemination of information crafted to meet the educational needs of local school systems) necessarily expanded to include both information and personal services which go far beyond the three R's. This is so for two reasons.

First, the majority of local school districts are financially incapable of unilaterally assuming the high cost of the type and quality of technical personnel required to develop a non-educational program specifically tailored to their school district. This is particularly true in the small to medium sized school district -- a district which otherwise could find itself in the unenviable position of terminating a classroom teacher in order to employ a technical professional wise in the ways of federal regulations and procedures.

Thus, local school districts have found that by working in conjunction with their state school boards association they are able to access the technical advice they need without asking the students to pay the price in decreased education effectiveness in the classroom.

Secondly, the high cost of federal mandates to local school districts has eroded the availability of the small sums districts once had available for development and implementation of innovative classroom techniques, particularly in the ever changing areas of math-science and hightech. Again, by pooling both money and resources at the state association level, local school districts are able to ease the financial burden associated with development and implementation of needed curriculum advances while continuing to meet the demands of non-educational federal mandates.

It is ironic that in a time when the cost of even a basic education has never been higher, local public schools must continue to assume financial responsibility for an ever growing range of federal mandates wholly unrelated to education. If this trend continues, the role of state school boards associations as information facilitators and personal service providers must be allowed to expand, rather than contract. Furthermore, NSBA believes that this trend has resulted in a situation wherein no service or product offered by a state school boards association to a local school district is "unrelated" to the purpose of furthering local school district operation.

V. STATE SCHOOL BOARDS ASSOCIATIONS FILL SERVICE VOIDS CREATED WHEN PRIVATE INDUSTRY ABANDONS THE PUBLIC SECTOR

Unlike the private sector, the public sector is unable to shut the door on its business when it becomes unprofitable or undesirable to continue operation. In such cases, "competition" exists at the whim of market fluctuations.

For instance, over the past three years, school districts across the country found their insurance policies cancelled or were notified that such policies would not be renewed. In the majority of cases, cancellation and/or refusal to renew insurance coverage was not based on a negative claims history. Rather, such action on the part of private industry was in response to a combination of economic factors both unrelated to, and outside the control of, local school districts.

Clearly, private industry has no legal obligation to provide local school districts with liability insurance. Alternatively, the imprudence of operating a school system absent full liability coverage cannot be over exaggerated.

The imposition of each new federal mandate inherently carries with it a new cause(s) of action against a local school district. Many of these new causes of action, such as section 1983 suits, are the result of federal statute and regulation vesting a new right in an individual or class of individuals. Others are predicated on the establishment of a new legal duty, obligation, or responsibility to act or refrain from acting on the part of the local school board or an employee of a local school district.

At the behest of their members, state school boards associations responded to the challenge of meeting the void occasioned by the withdrawl of insurers from the local school district market. State school boards associations established self-insurance pools for their school districts and implemented investment trusts for the purpose of ensuring the continued safe operation of local public schools.

NSBA believes that no service provided by state school boards associations which ensures the continued safe operation of a local public school is unrelated to a state school boards association tax-exempt purpose. This is particularly true when, as in the case of insurance, the service is undertaken in an unreliable market abandoned by the private sector.

Furthermore, NSBA contends that parity of competition between the public and private sectors is not advanced by the imposition of a corporate tax on such a service. Rather, the imposition of such a tax would create disparity in the market place, effectively compelling local school districts to return to a private sector which folds up its tent and goes home when the profit margin is inadequate. By any definition, such a situation cannot be deemed "competitive".

NSBA believes that the issues raised by allegations that tax-exempt organizations "compete" with private industry for profits (and should therefore be subject to corporate tax tables for the purpose of parity) must be evaluated on the basis of the **consistent availability** of the goods and/or services **on an equal basis** to all potential buyers. In the case of insurance, it would be factually incorrect to assume that the service of underwriting premiums is, or has been, either available or consistently marketed to all potential buyers on an equal basis.

VI. THE DEFINITION OF UNRELATED BUSINESS INCOME SHOULD NOT BE PREDICATED ON THE MERE FACT THAT PRIVATE INDUSTRY ENGAGES IN THE SALE OF A PARTICULAR GOOD AND/OR SERVICE OFFERED BY A TAX-EXEMPT ORGANIZATION

Under current law, a finding that "unrelated business income" has been generated by a tax-exempt organization is predicated on the **direct relationship** of the revenue generating **activity** to the **tax-exempt purpose** of the organization. Recently, various segments of the private sector have proposed that parity between the public and private sectors demands that such a determination be predicated on the presence or absence of private industry in the market.

In the case of state school boards associations, NSBA believes that the presence or absence of private industry in a particular market is irrelevant to a determination of whether income is unrelated to the tax-exempt purpose of the association.

VII. CONCLUSION

It cannot be said that the purpose of the federal mandates which have been imposed on school districts are less than erstwhile or that they do not embody the highest American principles of fairness and equity. Alternatively, these federal demands have transformed the one room school house which served students six hours a day into complex facilities which employ and provide direct services, **on a daily basis**, to more Americans that any other unit of federal, state, or local government.

The principle revenue source for the operation of local public schools has not changed in over 100 years. It continues to be state income and local property taxes. Unlike the Federal Government, local school districts cannot design a particular program and compel another level of government to absorb the costs of implementation. Unlike the Federal Government, local school districts are incapable of expanding their tax base or shifting the burden of providing certain services to another unit of Federal, state or local government. Unlike other educational institutions, including state operated colleges and universities, local public schools are prohibited by law from excluding undesirable students, students with significant health problems, or students with severe emotional problems, of charging a student fee for access to core curriculum or requiring minimum performance standards. Rather, local public schools are charged with the responsibility of educating **all students equally**.

Again, state school boards associations were created, and are governed, by the local, elected officials who are directly responsible for the governance, operation, and management of the nation's 16,000 school districts. The purpose of these associations, as non-profit organizations, is to assist local school districts in achieving their purpose. In that regard, if local school districts are to continue to meet both the educational demands of the 21st century and a myriad of non-educational federal mandates, they must continue to have unfettered access to an organization of their creation -- an organization that is responsive to their immediate needs and which can assist them to plan for the future.

NSBA does not believe that the intention of this Committee is to incapacitate those organizations created for the singular purpose of providing local units of government, and school districts in particular, with the assistance they need in order to comply with federal law while continuing to meet the obligations they were created to fulfill.

Therefore, we respectfully request that when this Committee adjourns to review the testimony elicited over the past several days, that it will recall that local school board members, as elected officials responsible for the governance, finance, and operation of local public schools, created state school boards associations to assist them in their efforts and for no other purpose. NSBA believes, and we hope that this Committee will agree, that tax-exempt organizations created for the purpose of supporting units of government -- particularly local public schools -- are unique, are desirable, and by their very nature do not engage in "unrelated" income producing activities, nor are they capable of meaningful "competition" with the private sector.

Chairman PICKLE. Mr. Chairman, may I be recognized?

We are glad to have gotten your testimony before you had to leave, Mr. Howe.

Mr. HOWE. Thank you, sir.

Chairman PICKLE. Before we go forward with this panel, there's something I would like to know. You seem very concerned that we might get involved in the National School Board Association's work. I'm trying to understand what you do that's income producing. What do you have? I don't understand where you come into this picture.

Do you have businesses going on at the school boards?

Mr. HOWE. We are a 501(c)(3) organization. We provide seminars, we provide materials to local school districts, we provide facilities to State school board associations from the National School Boards Association point of view. We work with State school board associations, such as the Texas School Boards Association. We worked with them in creation of a massive insurance program which addresses the needs of school districts in the State of Texas, for example, Mr. Chairman, that would be related to liability insurance, workers' compensation insurance, addressing the issues of other programs of risk management, and that is facilitated through a not-for-profit exempt organization.

Chairman PICKLE. So you have an insurance program.

Mr. HOWE. That would be one, yes.

Chairman PICKLE. That would be one.

Do you have gymnasiums, do you rent out gymnasiums? Would you consider that as——

Mr. HOWE. The local school system might. But we ourselves as associations do not. And the school systems themselves would be instrumentalities of government.

Chairman PICKLE. I understand.

Do you get income from the stadium? Is that questionable? Is that used?

Mr. HOWE. That would not be of a concern to us.

Chairman PICKLE. All right. You don't have vocational classes, that's not in competition.

Mr. HOWE. The local school system might.

Chairman PICKLE. All right. What about the bookstores, libraries?

Mr. HOWE. Many local school systems have libraries, have bookstores, just as you would find in higher education.

Chairman PICKLE. And that is one item in question, how bookstores should be classified.

Is your association concerned with liability insurance? I'm just trying to get at what income producing activity you have.

Mr. HOWE. Okay. We would have, as would any trade association, professional society, we would have many of the same kinds of programs. We would have educational programs for our members; we would have conventions and expositions which would be related to our membership; we would be putting on other types of programs to increase public awareness of school board leadership, of the needs for quality education to present testimony to Congress and the like.

Chairman PICKLE. I want to ask our staff to be in touch with you because I still don't have an idea of what you're doing. I hear you talking about not changing the law; but, I don't understand what you really do. We're going to be in touch with you.

Mr. THOMAS. Would you yield on that point?

Chairman PICKLE. Yes, I yield.

Mr. THOMAS. I assume you put out some kind of a school board monthly or some kind of a publication?

Mr. HOWE. We put out several.

Mr. THOMAS. In which you solicit advertising, knuckle proof rulers or whatever else. But people want to advertise to get to the people that they are dealing with, and that more than pays for the cost of the publication.

Mr. HOWE. We also, I would add, Congressman, pay unrelated business income taxation on that advertising income over expense.

Mr. THOMAS. And then those who advertise also buy space at conventions?

Mr. HOWE. That is correct.

Mr. THOMAS. And that's covered UBIT as well?

Mr. HOWE. That would not be UBIT because of the changes in the law going back to 1976 so long as it was part of an educational process that such income would not be subject to taxation.

Mr. THOMAS. Why is someone having an advertising booth at a convention not covered when they advertise in the publication it's covered?

Mr. HOWE. Because it's——

Mr. THOMAS. What's the definition?

Mr. HOWE. Two reasons primarily. The law specifically exempts, if you meet certain provisions under section 513 of the code for a convention or exposition that that would not be subject to taxation; whereas, advertising based upon the decisions not only of the Supreme Court but the Internal Revenue Service have made it very clear that advertising is an unrelated business activity and thus is subject to taxation.

Mr. THOMAS. Thank you, Mr. Howe.

The point being that again we may have to look at the law because, by definition, it is excluded and no amount of regulations are going to change that.

Thank you, Mr. Chairman.

Mr. DORGAN. Mr. Howe, thank you very much.

Mr. HOWE. Thank you very much.

Mr. DORGAN. The subcommittee will next hear from Ray Jones, the member of the legislative task force, Texas Hearing Aid Association.

Mr. Jones.

STATEMENT OF RAY JONES, MEMBER, LEGISLATIVE TASK FORCE, TEXAS HEARING AID ASSOCIATION

Mr. JONES. Thank you, Mr. Chairman, and members of the committee. I am Ray Jones, a hearing aid dispenser in Texas for the past 20 years.

I am president of the Texas Hearing Aid Association that represents over 218 businesses that fit and dispense hearing aids, and their 800 plus employees.

We have written comments to the committee and will supply further written comments to provide support. What I would like to do today is to clarify the problems of so-called nonprofits and the impact they are causing on the private sector businesses in Texas that are selling hearing aids.

My first encounter with nonprofits in the hearing aid business came in July 1983. The Easter Seal Society of Fort Worth, my hometown, said they needed to sell hearing aids because, and I quote, "needed audiological services for the indigent and low-income was not being met in Tarrant County." I found that hard to believe so I called the four State agencies in Texas that helped the poor and indigent in our State and found the following information.

In 1982, in Fort Worth, the Texas Rehabilitation Commission paid for 20 hearing aids. The Texas Health Department paid for 62 hearing aids. The Commission for the Blind paid for two hearing aids. And the Medicaid, Department of Human Resources, paid for 225 hearing aids. That was in Fort Worth. All of these agencies years ago had an agreement with private enterprise to help the hearing impaired in Texas, free enterprise and Government working together for those needed services.

I also found in my study that Fort Worth had 16 offices located throughout the county. They sold 4,800 hearing aids that year with 36 licensed dispensers. The average cost per aid was $414.69. The average wholesale cost was $153.50. The average overhead cost was $110 per unit.

The Fort Worth dispensers had an average income of $19,957.08 in 1983.

With this example throughout the State, the Easter Seal Society of Texas said, and I quote, "The reason the McAllen Bay Society dispenses hearing aids is because the for-profit dealers have priced many hearing impaired people out of the market with their cost markup."

The total cost of that society's aids was $154 fitting fee, plus the wholesale cost of about $140 per unit. About $300 per aid at that society, but in the McAllen newspaper, hearing aids are advertised daily for $379 in the private sector. And, of course, as you know, the private sector has to pay taxes and has no nonprofit benefits.

We are here to tell Congress that in Texas the Easter Seal Society is not the only nonprofit which is providing and engaging in unfair competition with the private sector. For example, the Aston Center at the University of Texas at Dallas Health Science Center, they sell hearing aids from $580 to $730. The West Texas Rehabilitation Commission in Abilene and the East Texas Treatment Center in Kilgore.

In conclusion, the tax exempt organizations have gone into widespread competition in the hearing aid industry. Not because of any real public need, but simply to generate revenue.

Thank you.

[The statement of Mr. Jones follows:]

TEXAS HEARING AID ASSOCIATION
222 N. Riverside Drive • Fort Worth, TX 76111 • 817/831-0592

BOARD OF DIRECTORS
JUNE 1986-JUNE 1987

PRESIDENT
Jeanne Marsh
810 N. Kansas
Box 1866
El Paso 79950
915/532-8636

PRESIDENT-ELECT
A. L. Burns
P.O. Box 1993
Texarkana 75504
214-793-2177

VICE-PRESIDENT
Larry Farris
6809 Blanco #170
San Antonio 78216
512 342-2299

SECRETARY
Doyle Goeber
6129 Amarillo Blvd. West
Amarillo 79106
806 355-5582

TREASURER
Wes McKinzey
267 Wynnewood Village
Dallas 75224
214/948-3273

IMMEDIATE
PAST PRESIDENT
Ambrose Dreiling
2911 Woodhaven
Carrollton 75007
214/242-0072

DIRECTORS
John Gehm
12801 Midway Road
Suite 403
Dallas 75244
214/247-1377

Bryan Golden
2702 S. Buckner Blvd
Dallas 75227
214/388-3405

Marvin Hampton
Olde Centre North
5003-G John Stockbauer Dr
Victoria 77904
512/573-9891

Richard Davis
1903 19th Street
Lubbock 79401-4683
806/762-2851

EXECUTIVE DIRECTOR
Jim Wilson
Wilson & Company
Public Relations
222 N. Riverside Dr
Fort Worth 76111
817/831-0592

June 4, 1987

TO: Subcommittee on Oversight of the House Ways and Means Committee

FROM: Texas Hearing Aid Association

RE: Unfair competition from tax-exempt (nonprofit) organizations and state government which are engaging in commercial enterprises.

The Texas Hearing Aid Association (THAA) is opposed to tax-exempt organizations and state government entering into commercial enterprises which are in direct competition with the tax-paying sector. THAA was founded in 1947 and represents 218 independent businesses which employ 80 percent of Texas' licensed hearing aid fitters and dispensers.

Over the past four years THAA members have complained that fierce competition from the non-tax paying sector is causing severe financial hardship. Non-profits which have been reported to us include The East Texas Treatment Center; Easter Seal Society of Odessa, Abilene, McAllen, Texarkana, Waco and Wichita Falls; and the West Texas Rehabilitation Centers of Abilene, San Angelo and Snider. Recently, a group of Dallas/Fort Worth hearing aid dispensers and audiologists pooled their funds and filed a lawsuit against the Callier Center for Communicative Disorders, which is a United Way funded agency and also receives funds as part of the University of Texas at Dallas (UTD). Callier is dispensing hearing aids.

Two methods are being used to skirt the Internal Revenue Service. At one UTD facility (The Aston Center) a concession is rented to a private enterprise operator who sells audiology and hearing aids. UTD receives indirect proceeds through the rent it charges. A second method used is the "sales agent" approach, whereby Callier Center uses an out-of-state mail order supplier. Callier says its hands are clean because it did not directly "sell" the hearing aid, but only acts as a "sales agent."

An IRS ruling appears to provide a loophole for tax-exempt organizations to sell hearing aids and audiology to its patients without loss of their exempt status, or subjecting the income produced to taxation.

This rule, however, is defended by many of these tax-exempt organizations as an integral part of an organization's program to test and evaluate patients with hearing deficiencies (and) contributes importantly to the organization's purposes of promoting the health of such persons.

Our members feel it is hard enough to compete against a clinic or hospital whose overhead is already paid without having to also watch tax-exempt advertising dollars being spent.

We are not saying all non-profits are abusing their tax-exempt status, but it seems obvious that many such institutions are now engaged in the sale and dispensation of hearing aids, not merely to provide more comprehensive or convenient services to their traditional patient populations, but rather to penetrate new patient populations and markets traditionally served by hearing aid specialists.

THAA received a published budget from one such non-profit center which purchased $130,000 worth of hearing aids wholesale in 1983. These hearing aids were sold in direct competition with two of our members in Abilene. In 1987 this problem has continued to spread throughout the state.

There is growing evidence that many such organizations have exploited their tax-exempt status as a means to further capture and control the hearing aid market and to displace the traditional role of the hearing aid specialist as an integral member of the hearing health care delivery team.

Mr. DORGAN. Thank you, Mr. Jones.

The subcommittee will next hear from Patricia Cole, president of the American Speech-Language-Hearing Association, Austin, TX.

STATEMENT OF PATRICIA R. COLE, PH.D., PRESIDENT, AMERICAN SPEECH-LANGUAGE-HEARING ASSOCIATION, AND DIRECTOR, AUSTIN CENTER FOR SPEECH-LANGUAGE-LEARNING DISORDERS

Ms. COLE. Mr. Chairman and members of the subcommittee, I am Dr. Patricia Cole, owner and director of the Austin Center for Speech-Language-Learning Disorders in Austin, Tex. I also am the current president of the American Speech-Language-Hearing Association, ASHA, on whose behalf I am speaking today.

ASHA is a scientific and professional organization representing 53,000 speech-language pathologists and audiologists nationwide. Our members' areas of concern involve primarily three types of activities: providing services and related products to persons with speech-language and hearing disorders, the educational preparation of persons who will enter the profession, and the conducting of research in speech and hearing science.

ASHA members work in a variety of tax-exempt and for-profit businesses, including their own private practices, hospitals, physicians' offices, speech and hearing clinics, rehabilitation agencies, and community service agencies.

ASHA is a 501(c)(6) organization, and many of our members are employed in 501(c)(3) agencies, and approximately 25 percent of our membership engage in full or part-time private practice in for-profit businesses. Therefore, ASHA has an interest in the unrelated business income tax issue from both the nonprofit and the for-profit prospectives. We have submitted extensive written comments for the record, and I will only highlight some of those today.

First, we recommend that the current UBIT statute rules and policies be maintained and strictly enforced by the IRS. If organizations are in violation of rules and procedures regarding unrelated income, these organizations should be required to pay taxes and penalties. However, we do not find that there are sufficient data to warrant making major changes in the statute or rules at this time.

There have been numerous allegations of inappropriate unrelated business activity and of unfair competitive advantages for tax-exempt organizations.

While isolated examples are cited in which nonprofit agencies are competing with for-profit businesses in the sale of products and services, we do not believe, at least in our areas of concern, that there are sufficient data available to determine whether on a widespread basis these problems as perceived are real.

We recommend that studies be undertaken to collect data on the activities of both tax-exempt and for-profit organizations in the area of health care and rehabilitation services. Revised IRS forms and improved information analysis for both tax-exempt and for-profit businesses may be necessary. These changes in reporting of the nature and extent of income should assist in describing existing activities and in identifying any existing abuses.

ASHA perceived considerable confusion on the part of many persons in both tax-exempt and for-profit organizations relative to the related and unrelated income issue. We suggest that information be provided in a single readable document to explain the statute and rules for related and unrelated business income so that this information is made clear to individuals at for-profit and in tax-exempt entities.

One issue raised frequently by members of our own association and by others is an example of unfair competition by tax-exempt organization relates to hearing aid dispensing.

As I have indicated, we represent persons who provide hearing help services, including hearing aids, in both tax-exempt and for-profit facilities. I can report on 1 fairly extensive and objective study that perhaps pertains to the extent to which hearing aid dispensing is done by tax-exempt organizations.

In 1984, the International Trade Commission completed a study of the impact of importing hearing aids on the U.S. hearing aid industry. They collected considerable data on the distribution of hearing aids in America. This study is important because it provides concrete data collected by an objective investigator. Of the 1,161,900 hearing aids distributed in the United States in 1984, according to the ITC data, 6,364, or considerably less than 1 percent, were distributed to institutions identified as nonprofit. The study did not separate for-profit from nonprofit hospitals and clinics. But, assuming that half of these were nonprofit, the total number of hearing aids distributed to nonprofit agencies in 1984 rises to 44,753, which is only 4 percent of the total U.S. hearing aid market.

The Veterans Administration and the Army and Navy are major U.S. Government purchasers of hearing aids. According to the ITC report, these Government agencies purchased about 10 percent of the hearing aids distributed in the United States in 1984.

Given these data that indicate that only 4 percent of the hearing aids distributed in the United States are to nonprofit entities with another 10 percent distributed through the VA and Army and Navy, we must seriously consider whether there actually is significant unfair competition by nonprofit agencies on a widespread scale in the dispensing of hearing aids.

ASHA feels very strongly that both for-profit and nonprofit organizations are essential in the health care and rehabilitation systems of our country. We believe that consumers are well served by having the choice of providers and facilities to meet their needs. The limited extent of competition that seems to exist in providing services for hearing impaired persons may indeed be a positive factor for consumers.

Mr. Chairman, thank you for the opportunity to provide information to the committee on unrelated business income tax issue.

As I have indicated, the American Speech-Language-Hearing Association represents individuals working in both the tax-exempt and the for-profit agencies. We are eager to assist your committee in its efforts to resolve these issues and will assist in collecting data in any way that we can.

Thank you.

[The prepared statement follows:]

STATEMENT OF THE AMERICAN SPEECH-LANGUAGE-HEARING ASSOCIATION

Mr. Chairman and Members of the Subcommittee, I am Dr. Patricia Cole, Owner/Director of the Austin Center for Speech-Language-Learning Disorders in Austin, Texas. I also am the current President of the American Speech-Language-Hearing Association, (ASHA) on whose behalf I am speaking today. ASHA is a scientific and professional organization representing 53,000 speech-language pathologists and audiologists nationwide involved in service delivery to individuals with speech, language and hearing impairment. Speech-language pathologists and audiologists provide diagnostic and rehabilitation services in such settings as the schools, community speech and hearing centers, hospitals, rehabilitation centers and in private practices.

We are pleased to have this opportunity to provide information to the Committee concerning application of the unrelated business income tax (UBIT) policies to income producing activities of organizations that have tax-exempt status under Section 501 of the Internal Revenue Code. ASHA is a 501 (c)(6) organization. Many ASHA members are employed in 501 (c)(3) agencies and approximately 25% of ASHA members engage in full or part-time private practice in for-profit businesses. Thus, ASHA is in a unique position to examine the unrelated business income tax issue from a number of perspectives.

In reviewing the issues concerning the unrelated business income tax, ASHA studied numerous documents such as Unfair Competition in the States, Unfair Competition by Nonprofit Organizations with Small Business: An issue for the 1980s, Federal Income Tax Exemption for Trade and Professional Associations, and "Business Income of Nonprofits and Competitive Advantage." These documents discuss in-depth the history of nonprofit organizations, the basis and procedures for obtaining federal income tax exemption and the tests used by the Internal Revenue Service (IRS) to determine if various business activities conducted by tax-exempt organizations are unrelated to their tax-exempt purposes and are, therefore, subject to tax. Thus, this statement will not dwell on general background issues concerning UBIT.

This statement is divided into two parts. The first part provides the specific recommendations of the American Speech-Language-Hearing Association concerning the unrelated business income tax issue. The second part discusses issues related to the dispensing of hearing aids in tax-exempt organizations and for-profit businesses.

PART 1: UNRELATED BUSINESS INCOME TAX

1. **RECOMMENDATION: Maintain the unrelated business income tax statute, rules and policies as they currently exist, and require strict enforcement of the UBIT rules by the Internal Revenue Service.**

The unrelated business income tax policy was included in the Revenue Act of 1950, incorportated in the Internal Revenue Code of 1954 and expanded in the Tax Reform Act of 1969 to apply to all 501 organizations. For 37 years the Internal Revenue Service and the courts have interpreted the UBIT statute and applied it to the income producing activities of organizations that have tax-exempt status. If, in the eyes of the IRS or the court, an organization is engaging in income producing activities that do not substantially relate to the purposes for which the organization has received its tax exemption, the income is subject to the unrelated business income tax.

The current rules concerning UBIT are not unduly burdensome or restrictive. We realize there may be differences of opinion about what is and what is not an unrelated business activity. However, during the past 37 years the IRS and the courts have developed procedures for determining if specific income producing activities are subject to income tax. By applying these procedures they have prevented most tax-exempt organizations from abusing their tax-exempt status. Major changes in the statute concerning UBIT would mean that the IRS, courts and tax-exempt organizations would have to engage in another lengthy process to develop new procedures and policies to interpret the law.

ASHA believes strongly that the current UBIT policies should be applied to tax-exempt organizations consistently. When such organizations are found to be in violation, they should be required to pay necessary income taxes and penalties.

2. RECOMMENDATION: Provide information on the differences between tax-exempt and for-profit businesses and ways in which they can use the revenue generated.

Many individuals are unaware of the differences between tax-exempt organizations and for-profit businesses that may be providing the same services in a community and many believe--mistakenly--that a tax-exempt organization can use the money "earned" in ways similar to a for-profit business. But there are significant differences. For example:

A. Funds obtained by a tax-exempt organization cannot be used to benefit an individual in control of the organization. There is no equity ownership of a nonprofit organization. Therefore, a tax-exempt organization cannot accrue equity benefit in the organization for the benefit of individuals. Any excess revenue generated by a tax-exempt organization must be reserved and used to carry out activities related to the organization's tax-exempt purposes. For-profit businesses can distribute excess revenue, or profits, to the owners or shareholders of the business. If a tax-exempt organization is dissolved the assets must be distributed for the public good; the assets of a for-profit business can be distributed to the owners or shareholders of the organization to benefit them as individuals.

B. Tax-exempt 501 (c)(3) organizations are limited in the kind and amount of political activities in which they may engage. For example, they are prohibited from using their funds for election campaign activities. Their direct and grassroots lobbying efforts also are limited. For-profit businesses can use their income to lobby for policies that will benefit the owners or shareholders.

C. Tax-exempt organizations are prohibited from issuing stock to obtain funds for expanding their programs and facilities. Monies for such activities must come from donations, dues and/or assessed fees. These monies usually come from the limited group served directly by the organization. But for-profit businesses that want to expand, can issue stock through broadly based economic channels or use funds accrued from profit making activities to expand.

D. Tax-exempt organizations are established to promote the public good. They are set up to provide services for individuals, regardless of income level, over a long period of time, even though such activity may not be economically advantageous. For-profit businesses may engage in activities designed for the public good and may be very public spirited. However, they are not bound by law to provide goods and services to individuals who cannot pay the full cost. Generally, they are not prepared to operate on a long term basis without making a profit. If a for-profit business does not make money, it will not stay in business to serve the community.

Communities also tend to use tax-exempt organizations differently than for-profit businesses engaged in similar activities. There is a tendency to refer consumers with limited financial resources to tax-exempt organizations and those with greater resources to for-profit businesses. In fact, many for-profit businesses refer consumers with inadequate income to tax-exempt organizations. This phenomenon is particularly prevalent in the health care field. Such activity places the tax-exempt organizations in jeopardy when the more autonomous for-profit businesses challenge their tax-exempt status. An erosion of community alternatives is the result. Perhaps a short-term gain for the for-profit business, but a long-term loss in community services.

E. Tax-exempt organizations and their activities are governed by many federal and state regulations that ensure the organization will be accountable to the public. The tax returns of tax-exempt organizations are available for public scrutiny. Most tax-exempt organizations are directed by volunteer boards that ensure that the organization functions in ways related to the purposes for which it was established. For-profit businesses also are governed by many state and federal regulations, but are not accountable to the government or the public for their actions at least as long as those actions do not conflict with the law. The policies and directions taken by for-profit businesses are dictated by the owners and the shareholders who benefit directly from the business.

F. Tax-exempt organizations do pay taxes on their unrelated business activities. Even though tax-exempt, an organization is required, by law, to pay federal and, in many cases, state income taxes at the regular corporate rate on all income producing activities that do not substantially relate to the purposes for which the organization is exempt. Generally, the organization cannot use all of the expenses incurred in carrying out its tax-exempt activities to offset taxable unrelated business income. Because of continuing concern about tax exempt organizations engaging in for-profit activities, the IRS routinely reviews the tax returns of tax-exempt organizations. Many IRS rulings and court decisions have resulted in a body of information related to the kinds of activities carried out by tax-exempt organizations that are exempt or subject to tax. In the past, tax laws favored the for-profit business to the extent that many for-profits providing the same services as the tax exempt organization did not pay any federal income tax.

3. RECOMMENDATION: Fund studies to collect data on the unrelated business activities conducted by tax exempt organizations and the perceived vs. real "unfair" competition advantage such agencies have over for-profit businesses.

Although many small businesses have claimed that tax-exempt organizations have an unfair business advantage over for-profit businesses there is little empirical evidence to suggest that such unfair advantage exists. It is alleged that tax-exempt organizations engage in many business or commercial activities that are unrelated to their tax-exempt purposes. But, hardly any data exist to support these allegations. ASHA recommends that the IRS collect data on tax-exempt organizations so that more accurate information is available on the size of the tax-exempt organization population and the kinds of unrelated business activities in which they engage. Data from the for-profit sector also need to be collected. Perhaps that will determine the validity of the for-profits' claim that they labor under an unfair competitive advantage. ASHA believes it is inappropriate to recommended any changes in current UBIT policies and enforcement procedures without a clearer picture of what is happening in tax-exempt organizations that could cause problems in for-profit businesses.

4. RECOMMENDATION: Review the current IRS Forms 990 and 990-T and for-profit tax forms and revise as necessary to provide more appropriate data for comparisons between tax-exempt organizations and for-profit businesses.

The IRS currently collects data from tax-exempt organizations on IRS Form 990 (Return of Organization Exempt From Income Tax) and IRS Form 990-T (Exempt Organization Business Income Tax Return). These forms do not always reflect all of the sources of revenue for a tax-exempt organization or provide accurate information on the kinds of business activities carried out by the tax exempt organization that may be subject to tax. The IRS and the tax-exempt community should review these forms and revise as necessary to ensure that sufficient and accurate data and information are collected to allow the IRS to determine the various sources of revenue for tax exempt organizations as well as the various business or commercial activities they engage in that are subject to tax. Such data and information should allow the IRS to enforce the UBIT policies more appropriately and provide needed information about tax-exempt organization activities that can be used to make changes in the UBIT policies that may be needed. Similar activity should take place regarding for-profit businesses. Major changes should not be made in the UBIT policies without these kinds of data.

5. RECOMMENDATION: Provide information on the various IRS and court rulings concerning unrelated business income tax.

In the 37 years that the UBIT policies have been in effect, there have been many IRS rulings, court decisions, General Counsel Memoranda, and other information interpreting the UBIT statute and rules. However, many individuals in the nonprofit and for-profit sectors are unaware of this information. It is recommended that this information be collected and placed into one, readable manual or document that can be used by individuals concerned with UBIT policies. Such a document would clarify the IRS and court positions on UBIT, provide guidance for tax-exempt organizations as they engage in various business and commercial activities, and answer many of the questions about the right of tax-exempt organizations to engage in business activities related to their tax exempt purposes.

PART 2: DISPENSING OF HEARING AIDS

One issue raised frequently by members of the American Speech-Language-Hearing Association and others as an example of unfair competition by tax-exempt organizations, relates to hearing aid dispensing. This section of the ASHA statement will discuss issues related to the dispensing of hearing aids by tax-exempt organizations and for-profit businesses.

ASHA represents speech-language pathologists and audiologists who provide services and related products to individuals with communication disorders in both for-profit businesses and tax-exempt organizations. ASHA's 7,000 audiologist members provide a broad range of services for individuals in need of hearing aids in a wide variety of tax-exempt and for profit settings including their own private practice, hospitals, physician's offices, speech and hearing clinics, rehabilitation agencies and community service centers. Some audiologists dispense hearing aids directly from their own inventory. Others perform diagnostic testing and post-fitting services but refer the person with a hearing impairment to a dispensing audiologist or hearing aid dealer to purchase the device. Some audiologists use the services of a mail-order company, whereby, the audiologist specifies the features of the hearing aid needed but the consumer orders the aid directly from the mail-order company. After the hearing aid is received, the audiologist follows up with fitting adjustment and rehabilitation services.

In order to examine the significance of the claim that tax-exempt organizations are engaging in unfair competition in the hearing aid industry, the Committee should consider the following five questions:

1. How much hearing aid dispensing is done by tax-exempt organizations?

2. How can hearing aid dispensing provided by tax-exempt organizations be distinguished from the other services they provide such as comprehensive aural rehabilitation programs?

3. What are the differences between the populations served and the services provided by for-profit businesses and tax-exempt organizations that serve individuals with speech, language and hearing impairment?

4. To what extent is the current UBIT statute enforced with regard to hearing aid dispensing by tax-exempt organizations?

5. What would be the effect of precluding or limiting the dispensing of hearing aids by tax-exempt organizations?

Complete answers to these questions are not readily available. However, there are some data that may be helpful to the Committee.

1. HOW MUCH HEARING AID DISPENSING IS DONE BY TAX-EXEMPT ORGANIZATIONS?

Data on this question are contained in An Assessment of the Impact of Imports under the Educational, Scientific, and Cultural Materials Importation Act of 1982, Public Law 97-446, on the U.S. Hearing Aid Industry, Report to the President on Investigation No. 332-215 under Section 332 of the Tariff Act of 1930, of the United States International Trade Commission (ITC). This study was initiated because U.S. hearing aid manufacturers were concerned that importing of hearing aids duty free undermined the competitive position that U.S. made hearing aids held in the U.S. market.

According to the report:

> "The federal government purchases of hearing aids accounted for 5% of U.S. consumption in 1984; other non-profit institutions 1

percent; and other hospitals and clinics, 7 percent. (Emphasis added).

Many questionnaire respondents asserted that it was impossible or impractical to discern the nonprofit status of their hospital and clinic customers. Imports sold to these organization amounted to 10.5% of total imports of standard hearing aids in 1984. Only 0.9 percent of U.S. producers' domestic shipments of hearing aids were sold to hospitals and clinics." (p. xiv)

The following figures are from the ITC Report.

Table 13.--Hearing aids: Percent allocation of channels of distribution used by U.S. producers and importers, 1984

(In percent)

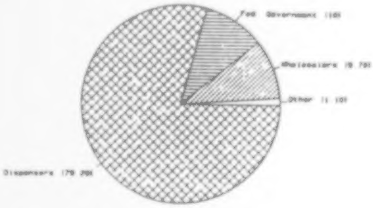
Channel of distribution	Standard		Custom	
	Producers	Importers	Producers	Importers
U.S. Government (* * *)	10.0	4.7	2.6	-
Other nonprofit institutions	.1	.9	.6	-
Dispensers (retailers)	79.2	68.0	87.0	71.1
Wholesalers	9.7	13.2	.1	1.2
Hospitals and clinics	.9	10.5	7.3	23.2
All other	.1	2.8	.2	4.5
Total	100.0	100.0	100.0	100.0

Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

Note.--Because of rounding, figures may not add to the totals shown.

Figure [illegible].--Channels of distribution for standard hearing aids used by U.S. producers, 1984

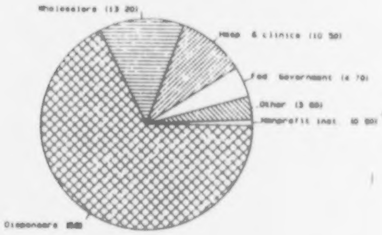
(In percent)



Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

Figure [illegible].--Channels of distribution for standard hearing aids used by U.S. importers, 1984

(In percent)



Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

Note that the Veterans Administration, the Army and Navy are the major U.S. government purchasers.

What do these data tell us? First, opponents of dispensing of hearing aids by tax-exempt organizations are not considering the fact that U.S. government purchases of hearing aids are not covered by the tax code. As a result, their concerns expressed about competition in hearing aid dispensing from tax-exempt organizations seem related to a very small segment (less than 1%) of hearing aid sales. According to the ITC data, U.S. producers of standard hearing aids made 277,900 units in 1984; only .1%, or 277, were sold to nonprofit institutions. U.S. producers of custom hearing aids made 623,000 units; of which 3,738 or .6% were sold to non-profit institutions. Imported standard hearing aid units numbered 261,000; .9% or 2,349 were sold to non-profit institutions. Standard hearing aids include behind-the-ear models, eyeglass models and body aids. Custom hearing aids refer to in-the-ear and canal models. Imported custom hearing aid units in 1984 numbered 60,000; none were distributed to non-profit institutions.

Altogether, of the 1,161,900 hearing aids distributed in 1984,according to the ITC data, 6,364 or .005% were distributed to non-profit institutions. Assuming that half of the hospitals and clinics are non-profit, the total number of aids distributed rises to 43,753, still a mere 4% of the total U.S. hearing aid market.

If this assumption is correct, one must ask whether any legislative changes are warranted to address such so-called 'competition' from tax-exempt organizations.

2. HOW CAN HEARING AID DISPENSING PROVIDED BY TAX-EXEMPT ORGANIZATIONS BE DISTINGUISHED FROM THE OTHER SERVICES THEY PROVIDE SUCH AS COMPREHENSIVE AURAL REHABILITATION PROGRAMS?

Any statutory or regulatory change regarding the ability of tax-exempt organizations to dispense hearing aids must be evaluated in terms of the full range of services offered by such organizations in the area of speech, language and hearing. Typically, these services involve the professional services of audiologists and speech-language pathologists. Numerous devices, other than hearing aids, are often provided to persons with impaired speech, language or hearing ability, including augmentative communication systems for persons with very limited or no ability to speak, and assistive listening and alerting devices for hearing impaired persons.

Frequently, the patients served in hospitals, clinics, or community service agencies are in need of multidisciplinary services and devices from an array of health and rehabilitation professionals. Some of these facilities are specifically designed to provide services to persons with physical or mental impairments and with multiple handicaps. Services often are paid for by Medicare, Medicaid, Vocational Rehabilitation, Title XX, Education of the Handicapped Act and other federal, state or private insurance programs.

To prevent these facilities from dispensing hearing aids and other related products as part of their treatment/rehabilitation program, would put a curious hole in their array of comprehensive services, burden the handicapped person with seeking another provider to obtain needed services, and raise questions about the continuum of care and services provided by other professionals who may be providing comprehensive services within the same facility.

3. WHAT ARE THE DIFFERENCES BETWEEN THE POPULATIONS SERVED AND THE SERVICES PROVIDED BY FOR-PROFIT BUSINESSES AND TAX-EXEMPT ORGANIZATIONS THAT SERVE INDIVIDUALS WITH SPEECH, LANGUAGE OR HEARING IMPAIRMENT?

ASHA has little data on the differences in speech-language pathology and audiology services offered in for-profit businesses and tax-exempt organizations. Frankly, we would be surprised to find any significant differences. We are proud of the fact that speech-language pathology and audiology services can be provided efficiently and effectively in both for-profit businesses and tax-exempt organizations. In an earlier period of the profession's growth, there was a stigma regarding dispensing hearing aids for profit in our field. That attitude has changed, however, as professionals recognized they are ethically bound to provide services in accordance with patient needs, including the dispensing of hearing aids. At the same time, the stigma has been removed from for-profit practitioners who also are recognized as performing a valuable service by providing access to quality services to more and more people.

This is not to say that the existing system for delivering services to hearing impaired persons does not need improvement. A 1986 report of the Office of Technology Assessment (OTA), Hearing Impairment and Elderly People, A Background Paper, provides a number of insights. According to OTA:

> "The existing service delivery system does not provide access to optimal treatment, devices, and services for many hearing impaired elderly people...These problems have been solved in some hospitals and university-based speech and hearing clinics that combine medical and audiological services and the capacity to dispense hearing aids and other devices." (emphasis added)(p.54).

The OTA report makes no reference as to the tax-exempt status of providers. However, we assume that most, if not all, of the university-based programs, and many of the hospital-based programs are tax-exempt institutions.

The OTA report also states:

> "Most hearing services for elderly people are provided in the offices of physicians, audiologists, and hearing aid dealers. To a lesser extent, hearing services are also provided in health care and educational settings and in multi-service community agencies. Although certain services, such as medical and surgical treatment, can only be provided in health care settings, others such as aural rehabilitation can be provided in a variety of settings. In some instances, the character of apparently similar services may differ when they are delivered in different settings. In other instances they may be virtually identical. Reimbursement for services, however, depends heavily on the setting where they are provided...
>
> Most hearing services provided by health care institutions are delivered on an outpatient basis, in either hospital-based or independent speech and hearing clinics. Diagnostic and rehabilitative services are usually provided, but the emphasis is on short-term care...Occasionally, hearing services for older people are provided by local health departments and even mobile medical clinics....Hearing services are provided by some adult education agencies, community colleges, and university speech and hearing clinics....During the past decade, several States have encouraged community colleges to initiate programs for disabled students. While some of these programs offer primarily vocation oriented instruction to students, others offer comprehensive hearing services to adults of all ages...University speech and hearing departments are another source of hearing services and in some communities they are the major provider of services.
>
> These clinics are usually affiliated with the speech and hearing or audiology department of a university. This makes low-cost hearing services available since virtually all services are provided by students under careful supervision....University speech and hearing clinics often provide a wider range of hearing services than other settings, including comprehensive evaluation, aural rehabilitation, and fitting for hearing aids. Some also supply assistive listening devices...Many communities offer hearing services in multi-service agencies. For example, senior centers generally provide recreation, education, counseling and other social services for elderly people; some also offer hearing screening and other hearing services. Some communities also have speech and hearing centers that offer a wide array of services including hearing aid dispensing. They may also sponsor satellite programs in other community agencies where older people are likely to be served."(page 54-55).

This latter point has been further detailed in A Study of Programs and Services For the Hearing Impaired Elderly in Senior Centers and Clubs in the U.S.A. by Ilsrale Sela, Ph.D., Gallaudet Research Institute. According to the report, "Most of the centers surveyed were public, non-profit centers. Most were financially supported by public sources, but also relied heavily on themselves for financial revenues. Title III of OAA was the most frequent source cited for the main financial support of centers." (page iv.). OAA data indicate that 76.2% of the centers provided hearing testing and 64.2% offered hearing aid sales, service, or education. The other services offered included telecommunications devices for the deaf, sign language classes, captioned films, television decoders and visual alarm systems.

Clearly, a variety of settings and a wide range of services exist in both tax-exempt organizations and for-profit businesses for persons with impaired hearing. It would be a disservice to these persons to have the tax code dictate that only certain types of providers can provide services in the future, which in effect would create a monopoly for only one segment of the hearing care field.

4. TO WHAT EXTENT IS THE CURRENT UBIT STATUTE BEING ENFORCED WITH REGARD TO HEARING AID DISPENSING BY TAX-EXEMPT ORGANIZATIONS?

There are no significant data to answer this question. However, it is ASHA's experience that when a tax-exempt hospital or university speech and hearing department decides to initiate a hearing aid dispensing program, dispensers who once received referrals from that institution, frequently engage in vociferous advocacy efforts to maintain their source or referrals. Sometimes these efforts translate into questions about the institution's tax-exempt status. ASHA's National Office has received many requests from members seeking advice on how to handle local opposition to a hospital's decision to dispense hearing aids as part of its program of comprehensive services as allowed under Revenue Ruling 78-435 (attached). It is ASHA's understanding that several years ago, the National Hearing Aid Society (NHAS), which represents hearing aid dealers petitioned the IRS to change Revenue Ruling 78-435. IRS did not modify its ruling.

The sale of hearing aids by tax-exempt organizations seems to have been upheld as not subject to the unrelated business income tax when the dispensing is substantially related to the institution's educational mission, that is, the training of audiologists; or to its health care mission, that is, improving services to persons with communication impairment and other handicapping conditions.

5. WHAT WOULD BE THE EFFECT OF PRECLUDING OR LIMITING THE DISPENSING OF HEARING AIDS BY TAX-EXEMPT ORGANIZATIONS?

This question a difficult one. First, the Veterans Administration, and the U.S. Army and Navy are major tax-exempt purchasers of hearing aids. Would a limit on hearing aid dispensing by tax-exempt organizations mean the end of those federal programs?

Second, federal and state education and health discretionary programs would have to be re-examined. Many of these programs mandate services to hearing impaired children and adults, and limit eligible recipients of funding to those receiving services in tax-exempt agencies. If tax-exempt organizations could not dispense hearing aids, wouldn't sizable numbers of persons with hearing impairment be deprived of the very services to which they are now entitled? And wouldn't such a change require statutory or regulatory modification of a number of programs to allow for-profit businesses to serve this population?

Third, the distribution of non-profit hospitals and clinics that now provide services under Medicaid must be considered, (Medicare does not cover hearing aids or hearing aid evaluations). In many states, Medicaid does not reimburse audiologists engaged in private practice or hearing aid dealers. But Medicaid does reimburse institutional providers, including an indeterminate number of tax-exempt organizations. According to ASHA's latest data (1983), 41 out of 44 states responding to a Medicaid Service Survey indicated that states provided hearing aids to Medicaid recipients under age 21; and 27 of the states said they provided hearing aids to persons over age 21.

ASHA believes that consumers are well served by having a choice of providers and facilities to meet their needs. Both for-profit businesses and tax-exempt organizations offer valuable services. The limited extent of competition that exists in the dispensing of hearing aids is a positive factor for consumers.

There are over 21,000,000 individuals with impaired hearing in the United States. Rather than enact statutory changes that might restrict services, ASHA believes that the Committee on Ways and Means should explore ways to expand services. Repealing the exclusion in Medicare on hearing aids and hearing aid evaluations is a good place to start. We look forward to working with the Committee in that direction.

SUMMARY

Mr. Chairman, the American Speech-Language-Hearing Association supports the efforts of the Committee to obtain information on the Federal tax treatment of commercial and other income-producing activities of organizations that have tax-exempt status under Section 501 of the Internal Revenue Code. ASHA believes strongly that no changes should be made in current policies and procedures concerning the unrelated business income tax until enough information and data are available to identify the extent to which tax-exempt organizations engage in competitive, commercial activities and the specific competitive advantages that tax-exempt organizations have over for-profit businesses. Without such data and information, ASHA believes it is impossible to make public policy decisions concerning the unrelated business income tax issue.

ASHA favors vigorous enforcement of the current unrelated business income tax policies by the Internal Revenue Service. If tax-exempt organizations are engaging in business activities that do not relate substantially to their tax-exempt purposes, necessary actions should be taken to prevent abuse of their tax-exempt status.

Although the Small Business Administration has indicated there is unfair competition between tax-exempt organizations and for-profit businesses dispensing hearing aids, we believe that the data provided in this statement indicate that the problem is not of the magnitude that requires a change in policy concerning the unrelated business income tax. ASHA believes strongly that informed consumers should have a choice of providers from which they can choose to receive services. Such a choice should include services from both tax-exempt organizations and for-profit businesses.

Mr. Chairman, thank you for the opportunity to provide information to the Committee on unrelated business income tax issues. The American Speech Language-Hearing Association is ready to assist the Committee in its efforts to resolve those issues. Please feel free to contact us if we can be of any assistance to you.

For additional information regarding this statement and the ASHA recommendations please contact: Morgan Downey, Director, Governmental Affairs Department or Stan Dublinske, Ed.D., CAE, Director, State and Regulatory Policy, American Speech-Language-Hearing Association, 10801 Rockville Pike, Rockville, MD 20852. 301-897-5700.

REFERENCES

American Society of Association Executives. (1985). Federal income tax exemption for trade and professional associations. Washington, D.C.: American Society of Association Executives.

Burch, K. (1985). Unfair competition in the states: How to combat competition from nonprofit business ventures. Washington, D.C.: Business Coalition for Fair Competition.

Copeland, J. and Rudney, G. (1986). Business income of nonprofits and competitive advantage. Tax Notes, November, 24, 1986.

Copeland, J. and Rudney, G. (1986). Business income of nonprofits and competitive advantage--II. Tax Notes, December 29, 1986.

General Accounting Office. (1987). Tax policy: Competition between taxable businesses and tax-exempt organizations. Washington, D.C.: Superintendent of Documents.

Sela, I. (1986).A study of programs and services for the hearing impaired elderly in senior centers and clubs in the U.S.A. Washington, D.C.: Gallaudet Research Institute.

Small Business Administration. (1984). Unfair competition by nonprofit organizations with small business: An issue for the 1980s. Washington, D.C.: Small Business Administration.

United States International Trade Commission. (1986). An assessment of the impact of imports under the educational scientific and cultural importation act of 1982, public law 97- 446, on the U.S. hearing aid industry. Washington, D.C.: United States International Trade Commission.

U.S. Congress Office of Technology Assessment. (1986). Hearing impairment and elderly people--A background paper. Washington, D.C.: U.S. Government Printing

ATTACHEMENT

INTERNAL REVENUE RULING 78-435

Section 513.—Unrelated Trade or Business

26 CFR 1.513-1: Definition of unrelated trade or business.
(Also Section 501; 1.501(c)(3)-1.)

Unrelated trade or business; hospital; hearing aid sales. The sale of hearing aids to its patients by an exempt hospital whose primary activity is rehabilitating the handicapped, including those with hearing deficiencies, does not constitute unrelated trade or business under section 513 of the Code.

Rev. Rul. 78-435

Advice has been requested whether, under the circumstances set forth below, the sale of hearing aids by an organization exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code is unrelated trade or business within the meaning of section 513.

The organization is a hospital within the meaning of section 170(b)(1)(A)(iii) of the Code. Its primary activity is the operation of a clinic that provides various rehabilitation services to handicapped persons, including those with hearing deficiencies.

In the course of its activities, the organization tests and evaluates the hearing of its patients with hearing deficiencies, and recommends such types of hearing aids as may be necessary in each case. Patients who wish to purchase hearing aids from the organization may do so. Upon purchase, the organization fits the hearing aids to insure maximum assistance to the patients in the correction or alleviation of their hearing deficiencies.

Section 513 of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt functions.

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is "substantially related" only if the production or distribution of the goods or the performance of the services from which the gross income is derived contributes importantly to the accomplishment of the purposes for which exemption was granted.

The sale of hearing aids as an integral part of an organization's program to test and evaluate patients with hearing deficiencies contributes importantly to the organization's purpose of promoting the health of such persons. See Rev. Rul. 68-376, 1968-2 C.B. 246, for examples of relationships that determine whether a person is a "patient" of a hospital.

Accordingly, the sale of hearing aids to its patients, under the circumstances described, is substantially related to the purpose constituting the basis for the organization's exemption and is not unrelated trade or business within the meaning of section 513 of the Code.

Mr. **Dorgan**. Dr. Cole, thank you very much for your testimony.

The committee will next hear from Dr. Charles Garber, president, Structure Probe, Inc.

Dr. Garber.

STATEMENT OF CHARLES A. GARBER, PH.D., PRESIDENT, STRUCTURE PROBE, INC.

Mr. **Garber**. Thank you very much, Mr. Chairman, members of the committee.

My name is Charles Garber, and I speak to you today as the president of Structure Probe, Inc., an advanced technology professional services firm operating as an independent laboratory, specializing in the performance of electron microscopy for clients on a for-fee basis.

My firm is located in West Chester, PA. This is suburban Philadelphia, and my firm started in 1970. We employ about 35 persons, and I myself hold a Ph.D. in engineering and polymer physics.

I have been told that I have only 3 minutes to speak before you today and, therefore, I would call your attention to the written testimony that was submitted prior to today. You should note that I am one of only a very few persons that have ever brought legal action against a tax-exempt organization for unfair competition.

After 5 years and over $100,000 in legal fees, I was told by both the U.S. District Court in Philadelphia and the U.S. Appeals Court that although I was correct in that somewhere there was a line that separated what was and was not appropriate activity, the tax laws were written with sufficient ambiguity as to just where that line of appropriateness is drawn that I have not proved that the tax-exempt organization had done anything wrong and that I had to take my complaint to the Congress.

That final ruling happened in 1977 and, since that time, the problem has only become worse.

Last week, I was asked by the staff of this committee to be absolutely certain to address without fail the following three points:

Point No. 1, what specific nonprofit income-producing activities have caused my firm problems?

Research services, especially those offered as a result of access to expensive analytical instrumentation, such as electron microscopes.

In the case of universities, it is usually the sale of time on an hourly basis on their analytical instruments to commercial, and I mean industrial customers.

Please do keep in mind that I am not objecting to such research that is basic and fundamental in nature, that which would be suitable for inclusion in the student's thesis, would be intended for prompt publication, and would be otherwise contributing to educational objectives.

I am objecting only to that work which is being done for private sponsoring clients which would not be suitable for inclusion in a student's thesis and would not be intended for prompt publication. Such activity does not contribute to educational objectives, not is it even an appropriate activity for prestigious university at all. If such activity had to be discontinued, university programs would not suffer the slightest. The only ones who would suffer would be certain university faculty members who would experience fewer consulting and less income opportunities.

In a case of not-for-profit organizations, and I now make a distinction between universities, virtually all of their not-for-profits research service work is done for some customer, which could be Government, it could be industry, and sometimes even other academic institutions.

The research services offered by the not-for-profits, especially analytical services of the type I am describing, are also offered by for-profit taxpaying firms. One really has to ask how society benefits from such inequitable and unfair competition with firms like Structure Probe.

Point No. 2 that I was asked to respond to. Exactly what is the unfairness of the competition? The tax-exempt organization has much lower costs, not because they are more productive, not because they are more efficient or more innovative but because, (*a*) their equipment is usually obtained free as part of a Government grant, or possibly a donation from private industry, as is now being under the R&D Tax Credit Act, which has become another exacerbated of this problem; (*b*) freedom from corporate net income taxes at the Federal, State, and local levels; (*c*) freedom from State sales and use tax acts. This is true in most States; (*d*) the ability to import foreign origin scientific equipment duty free; (*e*) various unrestricted grants and appropriations from Government at all levels to further make up losses and, thereby, to insulate the organization from bad management decisions and, (*f*) the ability to attract donated equipment from industrial firms who can then claim a 25 percent tax credit under the R&D tax credit program for the donation. And, finally, (*g*) the freedom from certain property and other taxes.

Now, my point here is that for this committee to do something about the payment of Federal taxes, namely the so-called tightening up of the UBIT provisions, if this was all that was done, this would really be a profound disappointment, and that is because the UBIT really is only one of many, many advantages that a tax-exempt organization has over a for-profit competitor. Therefore, a far more substantive change is necessary in order to bring fairness in competition back to this marketplace. Forcing only the payment of taxes at the Federal level would only have a minor effect in terms of unfair competition.

Point No. 3, I was asked to give examples of tax-exempt organizations engaging in these activities and to what extent.

Well, there are many, many universities and not-for-profit research institutes involved. I would direct the committee to the proposals submitted by over 100 universities several years ago as part of the National Science Foundation funded regional instrumentation facility program. Because the program originally was to encourage academic and industrial cooperation, the NFS, in its request for proposals, actually encouraged the proposers to outline the extent to which they had already been doing work for industrial customers.

It would be a violation of my agreement of confidentiality with NSF to disclose the details contained in any of these specific proposals, or to disclose any of the panel discussions relative to these proposals.

The committee need look no further though than these proposals at NSF to see the enormous business, and I want to emphasize that it is a business that has been developed at some of our Nation's finest and most prestigious research oriented universities. Even some of the members of the NSF Peer Review Panel, on which I was also a member, were literally shocked at the extent to the commercial business activity and the size and resulting cash flow, totally outside of the bounds of accountability of the institutions involved, the Government auditors who monitor grants and contracts and, of course, the IRS.

Some specific tax-exempt organizations we encounter competitively on a routine basis would be organizations like the University of Pittsburgh, Georgia Institute of Technology and its engineering experiments station, Stanford Research Institute, and the list can go on and on and on and on.

The real point though is there can never be a justification for a tax-exempt organization to engage in activity that private capital is either already doing or would do if the tax-exempt spun off the activity as a for-profit activity. If this is not done, then the tax-exempt preempts private capital from perhaps ever entering that market and then, of course, there is a real limitation of competition.

I must point out that such a philosophy would not harm in any way the legitimate educational and research interests of our Nation's universities. Indeed, it would force the universities to continually focus their attention on new emerging analytical areas where private capital has not yet become involved. Such an approach would not harm any of the section 501(c)(3) not-for profits. Activities that later become competitive activities would have to be spun off as for-profit businesses, and those assets redeployed to new emerging areas, ones not currently being served by private capital.

But then there's the question, how would this all work out? After all, there are so many gray areas. Actually quite easily so long as strong disincentives existed, such as there are in the antitrust laws, to discourage tax-exempt organizations from erring on the wrong side of that line of appropriateness.

This way decisions would be made on the side of "when in doubt, don't compete." Treble damages, maybe even a jail sentence would constitute strong disincentives.

Also there could be a system of incentives to encourage tax-exempt organizations to redeploy assets that are approaching the line of appropriateness. For example, for some period of time, say 5 years, the parent could receive a 50 percent share of all Federal, State, and local income taxes, customs duties, sales and use taxes paid and so on. This is just one example of how it could be done. As a final thought, I would point out that it is indeed appropriate to analyze and research this most complex problem and issue. But certainly, such analysis should not become a substitute for action on this problem. Thank you very much.

[The prepared statement follows:]

Statement of Charles A. Garber, President,
Structure Probe, Inc.

My name is Charles A. Garber. I am speaking to you today, as the President of Structure Probe, Inc., an independent analytical, research and testing laboratory specializing in projects requiring the use of electron microscopy and related scientific instrumentation. We now employ about 35, half of which are involved with our laboratory services business, and the others involved with a laboratory supply business called SPI Supplies.

Structure Probe is a corporate member of a number of scientific, business and professional organizations, including the Scientific Apparatus Makers Association (SAMA), the National Federation of Independent Business (NFIB), the American Council of Independent Laboratories (ACIL), and the Electron Microscope Society of America (EMSA).

Also, I am personally a member of a number of scientific professional societies including the American Chemical Society, American Physical Society, Association of Research Directors, Electron Microscopy Society of America and the American Society for Metals.

By way of education, I hold a B.S. in Chemical Engineering (U. of Illinois), M.S. in Chemical Engineering and Polymer Physics (Case Institute of Technology) and a Ph. D. in Engineering and Polymer Physics (Case Institute of Technology).

By way of additional background, I served as an elected delegate to the White House Conference on Small Business in both 1980 and 1986. In both Conferences, I played a major role in shaping those "recommendations" that eventually emerged relating to the subject of unfair competition from tax-exempt organizations with small business. In 1980, the subject received attention from a small minority of delegates (it did not make the top 15 "priorities") but, in 1986, it was voted the #3 most important issue facing all small business. Clearly, the magnitude of the problem is rapidly expanding, and the negative impact on small business are at crisis levels.

In order for you to better understand how I came to speak before you today, let me explain that my entire graduate school career, at Case Institute, involved the use of electron microscopy to solve my thesis problem. My first job (in December 1967) was with E.I. DuPont de Nemours & Co., Wilmington, DE, where I accepted an entry level position as "research physicist" and was in charge of the electron microscope laboratory in what was then the Plastics Department.

By late 1969, I had decided to strike off on my own, and since the one thing I knew better than most other people, namely the use of the electron microscope to solve industrial problems, I decided to start an independent laboratory specializing in problem solving with this new advanced technology technique. I had done my market research carefully, and the Delaware Valley (Philadelphia Metropolitan Area) seemed like an excellent market for such business. The closest competitors were in Wilmington, DE, Schenectady, NY, Boston and Washington, DC. All were small for-profit independent laboratories, and all seemed to be doing quite well in this newly emerging technical area.

It came as a real shock to me to find out that at about the same time (actually a few months earlier but unknown to us) the large not-for-profit Franklin Institute in Philadelphia took delivery of an almost identical scanning electron microscope (SEM) and began offering services identical to what was being offered by Structure Probe. The only difference was in the price charged per hour; while laboratories generally were charging about $80/hour, and Structure Probe was charging about $65, Franklin was offering comparable services at less than $45.

In the Fall of 1972, our firm filed a suit in Federal District Court in Philadelphia (#72-2071) and for over five years, which included a trip to the U.S. Court of Appeals, Third Circuit (#78-1961), our small firm carried on this "David vs. Goliath" battle. In the end, we lost.

While both courts agreed that there was a difference between tax-exempt and for-profit organizations in terms of activities that were and were not permitted, they also concluded that Congress drew the line separating the two with such ambiguity that we had not proved Franklin had broken any laws. The point was that the issue ultimately was a matter for Congress to decide, not the courts.

Shortly after the final Appeals Court decision, Franklin Institute, which was also a large science museum, reincorporated the "Research Laboratories" as "Franklin Research Center, Inc." a for-profit firm.

While the litigation occurred over ten years ago, there are some very important lessons to be learned from the record, and they are readily verifiable for anyone wanting to dig them out:

1) Even though through all this time Franklin was operating a major business/commercial activity, in direct competition with for-profit firms, absolutely no unrelated business income tax (UBIT) was ever paid.

   It is said that as human beings we can rationalize just about anything. This was certainly true with Franklin. No matter how repetitive, no matter how routine or mundane, no matter how competitive with for-profit firms, the activity was somehow always deemed to be "related" to their chartered purposes and therefore always "exempt" from the UBIT.

2) The Tax-Exempt Services Branch of the IRS in Philadelphia was totally intimidated by the mystique of the Franklin Institute. Indeed, I couldn't even get the IRS to respond to my letters even when I pointed all of these facts out to them.

   The IRS then, and unfortunately as it is set up today, is totally unable to recognize when they are being "had" in this way. One needs to only look at the tiny amount of UBIT that is collected annually from all tax exempt organizations; it is minuscule.

3) The freedom from federal income tax is only one of many advantages a tax-exempt organization has over for-profit competitors. Even if UBIT is paid, the tax-exempt entity still enjoys:

   a) freedom from state and local corporate net income taxes.

   b) exemption from (or reduced) local property taxes.

   c) access to nonprofit mailing privileges.

   d) duty-free importation privileges for certain types of scientific instrumentation and other equipment.

   e) freedom from the sales and use tax acts in many states.

   f) certain preferences, especially for grants, from certain federal government agencies.

   g) ability to attract tax deductible donations of equipment and facilities.

   h) other various benefits as well as the "nonprofit halo effect", namely the idea that somehow nonprofits are less profit-motivated and therefore provide a more objective service.

In other words, all other benefits flow automatically once the organization qualifies for its tax-exempt status. Even if UBIT was assessed as it was supposed to be, the tax-exempt provider would still have a substantial unfair advantage over its for-profit competitors.

4) Secrecy with which tax-exempt organizations are able to operate creates a far less accountable environment relative to their for-profit competitors. Many states (such as Pennsylvania) do not even have a nonprofit corporation act.

This means that even if a tax-exempt organization was subject to substantial UBIT and, in fact, did declare and pay it, the Commonwealth of Pennsylvania has absolutely no provision for collecting its own UBIT.

Although the Structure Probe, Inc. vs. Franklin Institute litigation commenced over ten years ago, what makes it still timely is that it represents perhaps the only time the officers and managers of a major not-for-profit have described, under oath, their operations, business strategies and rationale for making decisions. Many references were made to their "sister" institutions, that is, other not-for-profits operating under the same framework but which have never been challenged. Reading the record of this litigation should be mandatory for anyone who believes there is any substantial difference in operation between a not-for-profit vs. a for-profit counterpart, except that is, for their tax status.

As an independent laboratory, the so-called "nonprofit competition" we face can be segmented this way:

a) universities (Sec. 501-(c)-3).

b) not-for-profit (Sec. 501-(c)-3).

c) "donated" industrial laboratories.

a) Universities

Universities are the recipients of major instrumentation grants from a number of federal agencies including NSF, DOD, NIH, DOE, just to name a few.

It was always the intent of the Congress, if my understanding is correct, that these facilities are to be used exclusively for educational purposes, and for the conduct of research that is necessary to achieve those objectives. This would mean, for example, that projects conducted would be basic and fundamental in nature, the results would be suitable for inclusion in a student's thesis and intended for prompt publication. In other words, excluded would be projects that were not basic and fundamental in nature. Excluded would be projects for which prompt publication would not be intended. Excluded would be private proprietary work for which the sole beneficiary would be the "sponsoring" firm.

Unfortunately, and I am sorry to report, some of the faculty members in certain universities have been using scientific instrumentation for ways other than intended by Congress. In some instances, universities set up "industrial liaison" programs to "help" local (and sometimes not-so-local) industry. Instrument "time" is sold to industrial clients at rates far below any private sector rates because there is no need to charge for depreciation or other costs associated with the maintenance of the facilities. Oftentimes secrecy agreements are signed actually prohibiting prompt publication.

Worst yet is the case of the enterprising faculty member who uses these expensive facilities for the benefit of his "own private consulting business". In such a case, the faculty member is stealing. If he was privately employed, he could be charged with theft of services from the employer.

But somehow, in academia, such illegal activity is called "consulting".

In any case, such activity, whether appropriate or not by the university, is considered research, and therefore, by definition, is exempt from any taxation.

Tinkering with the UBIT would have absolutely no effect on this type of situation.

b) Not-For-Profit Organizations

Unlike the universities, these organizations, under section 501-(c)-3) are subject to the UBIT but only on "unrelated" activity. In the case of Franklin Institute, and apparently in the case of most such organizations, virtually all activity is somehow rationalized as being "scientific" or "safety" related (both outright exempt activities) or are somehow rationalized as being "related" to their chartered purposes.

Another common practice is to load all kinds of costs against the "unrelated" activity so the "unrelated business income" is never a "surplus". This is another ploy used to make sure no UBIT need ever be paid.

The end result is that no income is subject to the UBIT.

This is certainly the case at Franklin Institute, and apparently it must be true at most other Sec. 501-(c)-3 organizations (because nationally so little UBIT is collected from anyone).

Because of the collusion between the officers and managers of many of the nation's not-for-profits with their accountants and lawyers, I am of the opinion that there can never be any way by which Section 501-(c)-3 and its provision for the collection of the UBIT could be sufficiently tightened such that these providers of business/commercial services would be forced to pay any meaningful UBIT.

c) "Donated" Industrial Laboratories (DILs)

I would like to take credit for coining a new term, the DIL, or the "donated industrial laboratory". Consider some recent events:

1) General Electric Co. acquires RCA.

2) General Electric "declares" the basic research facilities of RCA "surplus" to G.E.'s needs and "donates" the RCA David Sarnoff Laboratories to Stanford Research Institute (SRI), a large not-for-profit based in Menlo Park, CA.

3) On the face of it, G.E. looks like a benevolent conglomerate, most of the employees, at least for the short term, keep their jobs, and perhaps everyone benefits.

Now, let's look more closely:

1) G.E. is rumored (I admit I have no facts on this) to be taking a 25% tax credit on this donation, because of a provision in the R&D Tax Credit Act.

2) If true, then a major research facility has been transferred from the for-profit to the not-for-profit sector. The tax base of the federal government, the State of New Jersey, and of course the local area has been shrunk substantially.

3) The new SRI-Sarnoff Laboratories are completely disrupting the marketplace for advanced technology research services, not because they are any better or more efficient, but because of their tax favored status.

Just what, I would ask, would "tightening up on the UBIT" accomplish here? I maintain nothing.

This is also a perfect example of how even the nation's most prestigious not-for-profits stop at absolutely nothing to exploit the tiniest loophole possible in the tax laws.

The 25% R&D Tax Credit Act was justified primarily on the basis that it would increase R&D spending by our nation's industrial firms.

A second section of the Act also permitted the credit to be taken for donations of equipment and facilities to the nation's universities and not-for-profits. This section was originally proposed by the nation's analytical instrumentation industry, which could help increase the turnover and therefore the market for analytical instruments.

However, I don't believe anyone in Congress ever envisioned that same section of the R&D Tax Credit Act would make it possible for large firms like G.E. to convert their unneeded research facilities into giant tax credits and create large not-for-profit providers of research services.

G.E. is far from being an isolated case. Gulf Research "donated" its basic research facility in Pittsburgh to the University of Pittsburgh and now it operates as a Section 501-(c)-3 organization.

And many more are in the planning stages. Some universities and existing not-for-profits are aggressively seeking additional DILs.

Gentlemen, the time has come to recognize one basic fact: If it looks like a business, runs like a business, acts like a business, then it is a business and it should be treated like a business.

The whole concept of UBIT was a bad idea when it was devised, and in 1987 as times have changed and circumstances have become even more complicated, then it is an even worse idea.

The UBIT concept must be thrown out, and a whole new concept replaced in its stead.

Surely, there are many tax-exempt organizations playing valuable societal roles and the last thing any of us would want to do, certainly not myself, is to harm in any way their ability to perform their legitimate activities.

But a line certainly has to be drawn, and it must be drawn without ambiguity as to what does and does not constitute appropriate activity for a tax-exempt organization. And when this line is drawn, it must be done in a way that it would be applicable not only to independent laboratories like Structure Probe, but to the many other types of businesses that are facing similar competition from tax-exempt organizations, be they health and fitness clubs, printing shops, travel agencies, etc.

I believe there is only one way to draw this line, and that is whether private capital is or is not available to provide such an activity. No more will questions of related to unrelated to chartered purposes become an issue. No more will the words "substantial" or "not substantial" in terms of sales not related to chartered purposes have to be answered.

Hence, if a tax-exempt organization started offering a service because none was being offered by private firms, that would be an accepted activity. Indeed, it would be an activity that should be encouraged. The tax exempt organization is indeed entering an activity that would not otherwise be available.

But, as times change and society's needs change, so might the question of appropriateness change. If private capital was to enter the marketplace, the tax-exempt organization should be given incentives to divest the activity in question so it would not be unfair competition for the private venture. Otherwise, private firms will be forever preempted from that marketplace.

Indeed, responsible not-for-profits have historically redeployed assets and funds when society's needs changed. For example, the March of Dimes organization, when polio was "solved", redirected its energies to fighting birth defects. It did not start producing a polio vaccine.

Now the question of incentives: Just what kind of incentives might be offered? Perhaps the divesting tax-exempt could receive a percentage of the profit (or perhaps a percentage of the taxes paid) associated with the divested activity. But the presence of incentives is most crucial; it has to be made attractive for the tax-exempt entity to "privatize" such activity.

But just as there should be incentives for the tax-exempt organizations to redeploy assets to other more needed areas, there should be severe penalties if divestment was not done on a timely basis. One penalty could be loss of tax-exempt status for a meaningful period of time (e.g. one year). One could also hold the directors of tax-exempt organizations personally accountable for violations of the rules for tax-exempt status.

But the guiding philosophy, and therefore the "tests", must be that never should a tax-exempt organization be engaging in an activity that competes with private capital. One might see the possibilities for quibbling, but I see such a system working much like the way the antitrust laws act as a deterrent for certain types of unfair business practices. The consequences are sufficiently severe that most firms would rather error on the safe side and not even come close to the "grey" areas.

While there may be instances of big firms being hurt by large tax-exempt organizations (e.g. for-profit insurers vs. Blue Cross), the issue affects mainly small businesses.

Based on my numerous discussions with delegates to the White House Conference on Small Business, the magnitude of the problem is continuing to increase. It is not a temporary phenomenon.

I see here a "window" of opportunity for some meaningful legislation to be developed that would have as its end result, the elimination of this type of unfair competition from tax-exempt organizations with for-profit business. This "window" will not open again for many years. If the thrust of this Committee will be to "fine tune" and "tighten up" the UBIT, it will be very sad, but the history has shown, time after time, that the UBIT approach just does not work.

I urge you to consider brand new fresh approaches, ones that will still encourage tax-exempt organizations to excel in those areas representing appropriate activity, rewarding them for turning over to the private for-profit sector, business/commercial activities that have matured into real businesses, but would still have harsh penalties for those tax-exempts that would adopt policies contrary to these proposals.

Mr. DORGAN. Dr. Garber, thank you very much for your testimony. Next, we will hear from Kingdon Hughes, owner of the Subsurface Library in Midland, Tex. Mr. Hughes.

STATEMENT OF KINGDON R. HUGHES, OWNER, THE SUBSURFACE LIBRARY, MIDLAND, TEX.

Mr. HUGHES. I am coowner and founder of the Subsurface Library in Midland, Tex. My partner and I started our log library business in 1962. We put all of our savings and virtually all of our assets into the founding of the business. We took one enormous risk, for I am sure that many of you will recall, that the oil business was almost as bad then as it is now.

In the full spirit of the American entrepreneur, we took substantial personal risks with no financial assistance from the Government or any other organization. Things were very hard at first. Several times, we thought we were going to have to close it down and do something else. You've heard it all before, but it's tough starting up a small business. Real tough.

Finally, slowly, it started catching on. Business picked up, but we had to do all the normal things. Lower membership prices, cut costs, let people go, and watch every penny. We have been in the basement of a building all of our life. We are not there because we love basements. We are there because that is all that we can afford. But we have made it. Looking back over 25 years of blood, sweat, and tears, we have made it; but now we are faced with a different kind of a threat, one that may be more formidable to any we have faced in the past. Namely, Government-subsidized competition in the form of a nonprofit log library.

Before I continue, let me digress for a moment to tell you what a log library is. It provides the basic tools for the petroleum geologist and the petroleum engineer, to help them find and produce oil and gas.

This particular set of tools is in document form. The most important tool that is in the library is electric logs which look very much like electrocardiograms. These recordings, or logs, tell the geologist and engineer what is in the hole in terms of oil, gas, water, rock, or whatever.

We have hundreds of thousands of these logs, just for an area covering West Texas and Southeast New Mexico. The second major tool we have is scout tickets. These are like summary diaries of what happened to a given well while it was being drilled and completed, how deep it was drilled, the kinds of formations encountered, what the geologist and engineer did to the hole, and so on.

The third tool that we offer in the library is production statistics that tell the geologist or engineer the volumes of oil, gas, and water that are produced by a given well in a given period of time.

The fourth tool we have are the county land maps that tell the geologist who owns the mineral rights to a specific area within a county and the location of all the wells drilled in that county.

The fifth tool we have is a sample log, which are diaries of the rock formations found in a hole at 10-foot intervals. All of these tools are vital components for helping the geologist and the engineer find and produce domestic oil and gas reserves.

Now, why am I here? Two or three years ago, a local group established a so-called nonprofit library to provide many of these same tools, if not all of these same tools, but at a much lower price.

They did not have to use private, independent risk-capital to set up their organization. They set up their nonprofit library with grants from several local foundations to open a business in competition with us. Their library does not have to pay taxes on the lower fees that it charges its members.

So the Government loses because the foundations are using their tax-exempt money that could be used for other programs, to underwrite a program that takes taxable fees from the private sector.

We lose because we have to compete with a library that pays no taxes and gets much of its funding free. Another aspect of this particular nonprofit library, that is especially detrimental to the Government, is that virtually all of the material that the nonprofit library has, has been donated to them at inflated values.

Their nonprofit status encourages the donors to seek and receive highly inflated appraisals of the value of the data. In most cases, if that data were offered for sale on the open market it would not be purchased at any price. We are not objecting, in any way, to the nonprofit library being a library open to the public and serving as a depository of the data, just like any other nonprofit library.

We do object to their charging a fee and not paying for the data. Their nonprofit status creates an environment that is tempting and conducive to this kind of abuse of the tax system. It does not seem right, that any kind of a business should be operated under a tax code that allows it to not have to take the kind of risks that a private party or entrepreneur has to take.

Those of us who put up our life savings to start and run a small business are being taken advantage of. They are offering their product at a price significantly below ours, and they can afford to do that, to a great extent, because they do not have to pay taxes.

I am not intimidated, in the least, competing with anybody who is operating under the same ground rules and playing on the same level playing field that I am. I will stake and have staked my business acumen on operating a library as well as anyone, as long as we are all playing by the same rules.

I do not think that the Government should be indirectly supporting any kind of business that is in direct competition with someone who has had to make financial sacrifices for their business.

In this case, there is no one outside of the Government who has had to make a financial sacrifice to put this nonprofit library in business. I think I have been as conscientious as any taxpayer in the United States about paying my taxes. I feel very strongly about paying my taxes because of the quality of life that this country has offered me. I owe my country something for that.

That is one reason why it is doubly hard for me to see why someone who is not approaching his business on that same philosophy should be given these kind of tax incentives.

I guess it is like my daddy always said—fair is fair, and this ain't fair. Thank you for your attention.

Mr. DORGAN. Mr. Hughes, thank you very much.

Next, the Chair will hear from Stuart Rabinowitz, president, Fiscal Planning Services. Mr. Rabinowitz.

STATEMENT OF STUART I. RABINOWITZ, PRESIDENT, FISCAL PLANNING SERVICES

Mr. RABINOWITZ. Thank you, Mr. Chairman, members of the committee.

I am president of the firm of Fiscal Planning Services, a management information systems corporation that provides timely and detailed information on the Federal budget to State and local governments.

Our firm has consistently been the victim of unfair practices by the nonprofit sector due to State and Federal policies. Fiscal Planning Services is in competition with not one, but two nonprofit organizations, that have jointly created a separate tax-exempt service to State governments, and to anyone else to whom they can sell their products.

One nonprofit organization represents the executive branch of all State governments, while the other represents all State legislatures. To my knowledge, this is the first time that both nonprofit organizations have jointly funded and created a separate entity which charges a fee for services, and is in direct competition with the private sector.

These not-for-profit organizations separately, and jointly market, share expenses, provide staff, space, and administrative costs in order to sell their product. It seems that nonprofit entities operate under preferential rules, providing them with a competitive advantage that is the antithesis of free enterprise.

Nonprofit organizations have a captive audience, a virtual monopoly with regards to a specialized service. They have access to a preexisting organization with staff, equipment, supplies, and office space.

As if these advantages are not enough, we pay taxes while they do not. Our products and services are of most value to Governors, budget offices, and legislative budget committee in each State.

However, the presence of a competitor sponsored and supported by associations representing State Governors and legislatures effectively limits access to the market. Members and staff of State government sit on the committee and the organizations that oversee my competition's product.

When asked to address what harm this has caused our firm, I can provide examples of unfair marketing capabilities when the State officials gather for any type of meeting. These organizations are allowed to market their products at no cost while our organization has to pay a vendor's fee.

We do not expect our competitors to advertise for us, but there is something wrong, and even deceptive, when these organizations advertise that there is no other service which will cover these grant-in-aid programs.

One incident that occurred only recently was when I made a presentation before a potential State client. I was told--and I quote: "We need to make your competition—meaning both nonprofit organizations—as good as you are. We need to make them better. We're not buying your services". That was the end of that quote.

Fiscal Planning Services is better than our competitors, but our access to State governments is restricted by a system favoring unfair competition. I am presenting to you clear cases where not-for-profit organizations, using subsidies, and direct access to markets, are able to compete unfairly against private-service firms such as ours.

When subsidization takes place on an international level of commerce we get angry. We pass legislation like the new trade bill. Sometimes, unfair practices occur closer to home.

Clearly, if not-for-profit institutions are competing directly with the private sector, we need a level playing field with fair rules for all. Such activities should be taxed, all costs should be treated as direct to that activity, and subject to normal business taxes and other requirements.

Access to markets should be opened by separating commercial enterprises from associations representing exclusive markets. State governments are my clients. I want the opportunity to continue working with them. If we do not deliver what our clients want, we do not make a profit, but when we lose a client to our competition, and when that client tells us we are better, I know it is time to ask the nonprofit sector be required to compete on a fair and equal basis. Thank you.

[The statement of Mr. Rabinowitz follows:]

Statement of Stuart I. Rabinowitz, President, Fiscal Planning Services

Mr. Chairman, members of the committee.

I want to thank you for holding these hearings on Unfair Competition of the Non-Profit sector as it affects private enterprise, namely the small business community.

I am President of the firm of Fiscal Planning Services, Inc, a management information systems corporation located in the District of Columbia. Members may be familiar with our work or the many reports we have produced in the past.

Fiscal Planning Services provides timely and detailed information on the fiscal impact of the federal budget on a program by program basis at the state and below state levels of detail. Our clients include state and local governments, national associations, labor organizations, the federal government and the private sector. Our products and services are of great use to state governments in preparing their budgets and determining future year appropriation levels.

I am presenting this testimony today because our firm has consistently been the victim of unfair practices by the non-profit sector. We are at a competitive disadvantage due to state and federal policies that promote the non-profit sector. I would like to illustrate this through actual events which have occurred since we began our corporation, in June of 1981.

My experience with state government showed me the overwhelming need for timely and detailed data on federal funds. Posessed with the entrepreneurial spirit, I believed that my firm could produce something useful to state and local governments, something that no other group or the federal government had ever provided.

The risk of leaving state government and starting a business in 1981, was much greater than I had imagined. Fiscal Planning Services was formed using capital from my two partners and the sale of my New York home. Purchasing equipment and supporting a staff, we began providing information to three state governments. We worked out of my home, working 80 hour weeks, and had our first office on K street within a year.

We knew we had a product with great value but with a very specialized market. More importantly , we felt that our firm was of social importance. We provided needed information in one book, unlike the previous "system" of pouring over stacks of computer printouts which we had used while I was in state government. Imagine, having a document at each stage of the budget process, showing the fiscal impact for each state for over 450 federal programs. No one had ever done this before. We did it, the first private, independent corporation to provide quantitative analyses of the federal budget in one concise well formatted book which has subsequently been given a registered trademark "FEDFACTS™."

A little over a year after we had begun producing FEDFACTS™ we were asked to submit a proposal to a national association representing state governments. We had several discussions and provided detailed information about our products and services including the type of computers and systems we were using along with schematics and other technical papers. We also provided detailed information on the sources of data we used to prepare our reports. Shortly after these discussions, this national organization went into a partnership with another organization representing state governments, both of which are non-profit entities with 501 C3 and C4 certifications, and began marketing budgetary data to state governments. They went into direct competition with my organization, providing a "similiar" product to state governments and using their clout to get an increasing number of state governments as clients. In fact, state governments did not use our services, with an already existing product but subscribed to the national organizations, services even before they had a product for distribution.

Moreover, the fee charged by this organization to state governments is nominal because of direct and indirect subsidies by the state governments themselves, and through other sources of revenue (i.e., charitable donations or foundation grants and grant monies from the federal government.

Competition on an equitable basis under the same rules for all parties concerned is one thing. But non-profit entities operate under preferential rules, providing them with a competitive advantage that is the antithesis of free enterprise. We have to market daily, spending inordinate hours building a nationally recognized organization, use our own funds to purchase equipment, supplies, etc. Non-profit organizations, on the other hand, have a captive audience, a virtual monopoly with regards to a specialized service. They have access to a pre-existing organization, with staff, equipment, supplies, and office space. They have access to funding, pre-existing revenue sources. As if these advantages are not enough, we pay taxes, while they do not. Could this entity survive if it had not been subsidized by state governments? Could rent, salaries, and equipment purchases be paid if they had to do it on their own?

My products and services are of most value to governor's budget offices and legislative budget committees in each state. However, the presence of a competitor sponsored and supported by associations representing state governors and legislatures effectively limits access to the market. Governors and state legislators serve as officers of the associations. These state officials are an integral part of associations with a vested interest in my competitors business. These associations provided the initial capital, are providing current office space, equipment, staff, and supplies, and have lent their names to my competitor's products and services. These associations are run by the same people who, in essence, decide which products and services are purchased by the state budget offices. This explains why some states seem more interested in promoting my competitor than in comparing the quality of services available.

Each state needs to know the expected amount of federal funds to prepare their budgets for the upcoming fiscal year. In many states, budget constraints allow them to subscribe to only one system. This decision is usually made by the budget division or fiscal agency directors, who serve at the pleasure of governors and state legislators. Often, they may view the relationship between my competitor and the associations as an implicit endorsement of the competitor's products by the associations. I am not surprised when my competitor is selected without a thorough review of the quality and quantity of products and services. I am also not surprised when groups unrelated to these associations select me after a complete and thorough review of all available products and services.

Members and staffs of state governments sit on the committees, in the organization that oversee my competitors product. When state officials gather for semi-annual meetings, these organizations are allowed to market their products at no cost while our organization has to pay a vendors fee to present our products and services. This is blatantly unfair. Being excluded by these organizations, our services are not publicized. We do not expect our competitors to advertise for us but there is something wrong and even deceptive when these organizations advertise that there is "no other service which will cover these grant-in-aid programs." Is it in the public interest when for some unknown reason a contract with a state government client is not renewed? Or when a two year signed contract with a built-in discount for the second year is canceled after the first year only to find out that my competitors now have that state as their client.

Federal and state governments have bidding procedures for consulting services, how can our firm bid competitively? Members of these national organizations do not calculate into the state bidding process those costs already associated with their dues structure. States have already paid for start up and maintenance over a period of years. Would a state that did not pay dues over this period of time pay the same dollar fee? We provide quality products, with additional services specifically tailored to each state that these other organizations cannot provide. But, when one looks at our pricing and their pricing on face value it would appear that we are more expensive. How does a government or other client calculate subsidized costs of our competitors product. Is my competitors product, in real terms, more or less expensive?

Recently, during a presentation to a state government I was interrupted in the middle of a sentence when the staff director of the state senate stood up, turned the light off and on, walked directly to me, introduced himself, shook my hand and stated "we need to make your competition as good as you are, we need to make them better. We're not buying your services." With that he walked out of the room. Make my competition better? Fiscal Planning Services provides additional services. We provide data on over 95% of all grant-in-aid and payments to individuals funds, both in federal and state fiscal years. We provide 100% client support. We provide substate analysis. We provide data on the federal tax burden by state and county. We provide information on how changes in the level of federal funds distributed by state governments affects counties. We are better, but our access to the state governments is restricted by a system favoring unfair competition.

Surely there should be some protections for the rights of small businesses such as ours against unfair - and I stress unfair- competition from non-profit organizations. I am presenting to you clear cases where a not-for profit institution, using subsidies and direct access to markets, is able to compete unfairly against private service firms such as ours.

When this subsidization takes place on an international level of commerce we get angry. When foreign governments limit our access to their markets or subsidize their products, we pass legislation like the new trade bill. Sometimes unfair practices occur closer to home. Clearly if not-for profit institutions are competing directly with the private sector, we need a "level playing field," with fair rules for all. Such activities should be liable to taxes and all costs should be treated as direct to that activity - the portion of staff, machinery and other costs used in providing that "profit activity" should be assigned to the activity and subject to normal business taxes and other requirements. Access to markets should be opened by separating commercial enterprises from associations representing exclusive markets. Why should small businesses be under the constant pressures of marketing their products, paying taxes, and other business related problems when non-profit institutions hide behind a system that has not provided the necessary protections to the small business community.

State governments are my clients, and I want the opportunity to continue working with them as a private sector for profit corporation. Our corporate clients keep us honest. If we do not deliver what our clients want, we do not make a profit. But when we lose a client to our competition, and when that client tells us we are better, I know it is time to ask that the non-profit sector be required to compete on a fair and equal basis.

Hill Taking New Look at Nonprofits

By Anne Swardson
Washington Post Staff Writer

On the face of it, the two enterprises seem like twins. Both are computerized services that forecast the effects of federal budget actions on state finances. Both are based in Washington, and both have been selling their information to states since the early 1980s. They are competitors for the same business.

But one has a bottom line and the other doesn't. Fiscal Planning Services is a private, tax-paying business; Federal Funds Information for States (FFIS) is a nonprofit entity exempted by law from taxation.

As distinctions between the business activities of tax-exempt institutions and taxpaying commercial businesses become increasingly fuzzy, a chorus of unfair competition complaints has come from business. Last August, the report of the White House Conference on Small Business listed competition from tax-exempts as the third-biggest problem facing small business.

In recent years, the competition between the taxable and the tax-exempt has cropped up among a wide range of interests, including universities, hospitals, athletic clubs, veterinarians, computer services, nurseries, research labs, laundries and travel agents.

This week the House Ways and Means Committee oversight subcommittee is scheduled to jump into the middle of this increasingly emotional debate with five days of hearings.

"I would like to know whether, if they [FFIS] did this by themselves and set up their company and rented the furniture and paid the taxes and paid the staff, they could do it without the subsidization they currently receive," fumes Stuart I. Rabinowitz, president of Fiscal Planning Services, the private company.

"As far as our dealings with the states are concerned, we are a state organization providing a service to the states," said Victor Miller, director of FFIS, which is affiliated with the National Governors' Association and the National Conference of State Legislatures.

The laws governing tax-exempt organizations and their business activities have been unchanged for nearly 20 years, and many on both sides agree they are confusing and inconsistent. Generally, such entities as charities, hospitals and universities are subject to tax on income from "unrelated" business activities, but determining what is related and what is not has been a subjective process.

The Internal Revenue Service ruled in one case, for example, that veterinary services offered by a tax-

See TAXES, H18, Col. 1

Hill Taking New Look at Nonprofits

TAXES, From H1

exempt humane society were taxable because they had no direct relationship to preventing cruelty to animals. Then it ruled that a similar operation elsewhere was not taxable, because the second humane society relied less on the veterinary services and did not promote them.

As the confusion grew over the years, so did the nonprofit sector. About 870,000 nonprofits are now registered with the IRS, more than double the number in 1963. And, according to a survey by the General Accounting Office, income-producing activities have grown as a share of revenue for nonprofit organizations, from 57 percent in 1946 to 75 percent in 1978.

Nonprofit hospitals, for example, have begun contracting out laundry services, purchasing ad agencies and operating real-estate developments. College bookstores sell blue jeans and computers, museums rent out their facilities for parties, alumni associations offer tour packages and trade associations sell computer software to their members.

A lobbying group was formed in 1983 to give voice to the complaints of such disparate industry groups as research laboratories and hearing-aid manufacturers. And individual businesses have challenged the tax-exempt status of their perceived competitors in court.

The business advocacy groups are concerned about competing against entities that pay no tax, but also say they have an unfair disadvantage against nonprofits that are taxed on their unrelated income.

A nonprofit's expenses often can be deducted from income, reducing tax. According to the IRS, more than half the 29 nonprofits reporting income of more than $2 million in unrelated business paid no tax. And there are other breaks, business groups say: lower postal costs, volunteer labor, property-tax exemptions and a good-guy image.

"Taxes are only the beginning of our concerns," said Joseph O'Neil, chairman of the Business Coalition for Fair Competition, the lobbying group. "It is, you might say, the host of advantages that are linked to tax exemption. There is an aura of public service, quality and concern that attaches to a nonprofit simply because it is associated in the public mind with a church, a charity or a university."

Nonprofit groups generally respond that they are happy to pay taxes on their "unrelated" income if so asked by the IRS; meanwhile,

their new enterprises generate r
enue that makes it possible to pur
charitable activities in an age of b
get cuts and austerity.

By taking their pets to a hum
society clinic, customers are "help
pay for the humane work on anin
that are not being paid for," said
tricia Forkan, senior vice presid
of the Humane Society. "All the m
ey goes into charitable work."

Robert A. Boisture, assoc
general counsel of the YMCA of
USA, says the fundamental qu
tion is "the role of nonprofit, vol
tary organizations in society . . .
were doing this long before
body thought about making a pr
on it. When the fitness fad fa
away and the health clubs fold,
"YMCA will still be there."

Despite the hearings, Congre
considered unlikely to move to
nificantly restructure the laws
erning tax-exempt activities.

But the hearings are likely
draw attention to the evolutio
the nonprofit sector since the
laws governing it were last ex
ined nearly 20 years ago.

And they should provide
theater: The panels are struct
so that each witness from a tax
business will appear side-by-
with his counterpart in the non
it sector.

Mr. **Dorgan**. Mr. Rabinowitz, thank you very much for your testimony.

The subcommittee will next hear from Frank Gambardella, president of the National Association of Portable X-Ray Providers. Mr. Gambardella.

STATEMENT OF FRANK GAMBARDELLA, PRESIDENT, NATIONAL ASSOCIATION OF PORTABLE X-RAY PROVIDERS

Mr. **Gambardella**. Yes, sir. Mr. Chairman, members of the subcommittee. My name is Frank Gambardella, and I am president of the National Association of Portable X-Ray Providers.

This is a national organization of tax-paying commercial portable x ray companies that furnish diagnostic x ray services to nursing home and home-bound patients. Virtually all portable x ray providers participate in the Medicare program.

Accordingly, each provider much comply with Medicare's conditions for coverage of portable x ray services. During the past few years, association members have faced increasing competition from, and lost business, to nonprofit tax-exempt hospitals.

They have begun to furnish x ray services to the same nursing home, and home-bound patients that we serve. Our specific complaint is they are not paying taxes on these services. Hospitals have traditionally served only their inpatients and outpatients, but now, they are seeking the business of nursing homes, and thus offering services to individuals with whom the hospital generally has no relationship whatsoever.

That is individuals who are nonpatients. The solicitation of this business by hospitals is appropriately characterized as "outreach testing". The Subcommittee should also be aware, that unlike members of our association, many hospitals do not comply with Medicare's conditions for coverages of portable x ray services.

While we do not object to fair competition, the competition engaged in by these hospitals is unfair because they do not customarily declare as income, or pay taxes on the revenue that they earn from providing the outreach services.

Not only is this practice unfair, it deprives the Government of revenue to which it is entitled. I appear here today to express our association's view, that current law requires that the income derived from this activity be taxed as unrelated business income.

Otherwise, the already existing revenue loss is sure to increase as hospitals expand their commercial activities and divert business from tax-paying entities. Clearly, for purposes of the subcommittee's inquiry, the first issue is whether in fact the income derived from the services provided by hospitals constitutes unrelated business income.

We claim that it does, because such activity meets the IRS's four criteria for unrelated business activity. It is, No. 1, a trader of business. It is, No. 2, regularly carried on. It is, No. 3, not substantially related to the hospital's performance of its exempt purpose or function. And four, it is not carried on by the hospital primarily for the convenience of its own patients.

Because of the limited time I have available to me, I will not review, in detail, the criteria that I just noted. I do, however, refer the subcommittee to the association's prepared statement, which fully explains that the outreach x ray service provided by tax-exempt hospitals satisfies the unrelated business activity test.

As support of our argument, I also refer the subcommittee to IRS Revenue Ruling 85-110, which although does not address the particular issue of outreach x ray services, it does consider outreach laboratory services, with the conclusion that the income derived from such activity is taxable because the hospital's provision of laboratory services to nonpatients constitutes unrelated tax or business.

We feel that an identical conclusion is appropriate with regard to the portable x ray services. The subcommittee is asked, do the present law rules permit unfair competition by exempt organizations, and, if so, how should the rules be changed?

As I believe that my testimony has made clear, the association believes that the present law rules, as interpreted and enforced, do in fact permit unfair competition.

To rectify this situation, the association offers the following suggestion. First, the IRS should replace the substantially related test with a new standard of commerciality. Under this test, the income generated by the commercial activity engaged in by a tax-exempt organization would be taxable as unrelated business income.

Again, the association refers the subcommittee to the association's proffered statement for further development on this proposal.

Second, the association submits that tax-exempt entities should be required to identify on the form 990, all types of commercial activity in which they engage. It should not be within the organization's discretion to decide these commercial activities that are related, and those that are not.

Moreover, the 990 and 990-T forms should be reviewed to determine whether they accurately reflect the total receipts that a hospital realizes from any commercial activity in which it engages.

Finally, the association suggests that IRS enforcement be strengthened so that tax-exempt organizations that either do not report, or mischaracterize their unrelated business income, can be readily identified, thus enabling the IRS to take appropriate action against these entities, capture more tax revenues, and help turn unfair competition into fair competition.

On behalf of the association, I would like to thank the subcommittee for this opportunity to testify on this important issue.

[The statement of Mr. Gambardella follows:]

STATEMENT OF THE
NATIONAL ASSOCIATION OF PORTABLE X-RAY PROVIDERS
BEFORE THE HOUSE WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
CONCERNING THE UNRELATED BUSINESS INCOME TAX

JUNE 1987

My name is Frank Gambardella, and I am President of the National Association of Portable X-Ray Providers ("NAPXRP" or "Association"). NAPXRP is a national organization of tax-paying, commercial portable x-ray companies who furnish diagnostic x-ray services to nursing home and home-bound patients. Virtually all portable x-ray providers participate in the Medicare program. The Health Care Financing Administration's most recent statistics indicate that there are 361 Medicare-certified portable x-ray providers in the country. To receive reimbursement from the Medicare program, each company must comply with Medicare's Conditions for Coverage of Portable X-Ray Services ("Conditions for Coverage"), 42 C.F.R. §405.1401 et seq. As a Condition for Coverage, x-ray services must be provided by qualified technologists who satisfy the program's educational and training requirements.

During the past few years, NAPXRP members have increasingly faced competition from and lost business to nonprofit, tax-exempt hospitals that have begun furnishing diagnostic x-ray services not only to hospital inpatients and outpatients, but to the same nursing home and home-bound patients served by portable x-ray providers. While competition is ordinarily beneficial, the competition that NAPXRP members confront is not. Rather, the competition engaged in by tax-exempt hospitals is unfair because such hospitals: (1) do not customarily declare income or pay tax on their commercial activities; and (2) customarily receive higher Medicare reimbursement than do portable x-ray providers for the same service. I appear here today to express NAPXRP's view that unless such commercial activity on the part of tax-exempt hospitals is subject to taxation, it constitutes unfair competition. Accordingly, Congress should require that the income derived from such activity be declared by non-profit hospitals and taxed as unrelated business income.

As an initial matter, NAPXRP would like to explain to the Subcommittee the service that Association members provide; the manner in which tax-exempt hospitals have entered the portable x-ray provider's market; and why the revenues earned by such hospital activity is taxable as unrelated business income. NAPXRP would also like to offer certain proposals that it believes would help to alleviate the problems currently experienced in this area.

Let me briefly explain the typical method by which portable x-ray providers obtain business. Although, as an initial matter, the provider depends on the order of a licensed physician to furnish an x-ray test, it is the nursing home that actually serves as the portable x-ray provider's client. The typical business relationship between a portable x-ray provider and a nursing home is as follows: The attending physician at the nursing home determines that his or her patient needs an x-ray; the physician advises the nursing home personnel that an x-ray is required; and the nursing home calls on the portable x-ray provider to come to the home to x-ray the patient. In some instances, the attending physician may place the order directly with the portable x-ray provider.

Until recent years, hospitals have, for the most part, furnished diagnostic x-ray services only to individuals who are either inpatients or outpatients of the hospital. In either case, the hospital had some relationship with the individual, whether the individual was actually admitted to the hospital or whether the individual simply visited the hospital outpatient department. Recently, however, non-profit hospitals, seeking additional revenues, have pursued customers outside of the hospital and begun to offer x-ray services to nursing home patients--individuals with whom the hospital generally has no relationship whatsoever. The solicitation of this business by tax-exempt hospitals is appropriately characterized as "outreach testing," i.e., the hospital reaches beyond its walls and holds itself out as available to provide services for persons who are neither inpatients nor outpatients. In most cases, hospitals obtain this business by aggressively promoting their x-ray services to a nursing home. Frequently, the hospital moves portable x-ray equipment into the nursing home and sends hospital technicians to the home to perform the x-ray service. As a general rule, the hospital does not open a file for these patients. And, as hospitals are not subject to the same Medicare regulations as are NAPXRP members, hospital technicians frequently do not satisfy the educational and training requirements of Medicare's Conditions for Coverage.

NAPXRP is aware of numerous hospitals that are engaging in and promoting outreach testing. Moreover, the incidence of this phenomenon appears to be on the rise throughout the country. Many portable x-ray companies have reported a loss of major nursing home business to tax-exempt hospitals. As most portable x-ray companies are small businesses, unfair competition of the scale presently offered by tax-exempt hospitals is threatening the very existence of many of these businesses.

If the Subcommittee feels that such information would be useful, NAPXRP stands willing to help the Subcommittee develop a comprehensive list of tax-exempt hospitals engaging in outreach testing. For the moment, however, let me simply recite four of the many examples of this type of conduct.

- One NAPXRP member reports that his company lost one major nursing home when a tax-exempt hospital placed portable x-ray units in the home. The hospital employs x-ray technology students to take the x-rays, individuals who clearly do not satisfy Medicare's Conditions for Coverage.

- Another member reports that at least three nursing homes discontinued using the member's service when local tax-exempt hospitals placed portable equipment in the homes.

- One member reports that he lost numerous homes, and a substantial percentage of his monthly business, to local tax-exempt hospitals. It is our understanding that the hospitals have not complied with Medicare's Conditions for Coverage.

- Another member lost the patronage of eight nursing homes within several weeks after a non-profit hospital began providing the service.

The Association believes that existing law requires that the income derived from this type of outreach service be taxed as unrelated business income. Yet, based on information received by NAPXRP in response to its request to the Internal Revenue Service ("IRS") for publicly-available Form 990s, it appears that many hospitals providing such services do not file Form 990-Ts concerning unrelated business income and therefore, pay no taxes on such income. This practice of avoiding taxes for unrelated commercial activity constitutes unfair competition. Moreover, it deprives state and federal governments of tax revenues to which they are entitled and that they formerly received from the tax-paying portable x-ray providers who were displaced by the hospitals. This revenue loss is likely to increase as hospitals expand their outreach activities and divert business from tax-paying entities.

For purposes of the Subcommittee's inquiry, the first issue that must be addressed is whether, in fact, the income derived from a tax-exempt hospital's outreach testing constitutes unrelated business income, taxable under Sections 511 and 513 of the Internal Revenue Code. NAPXRP submits that it does. Under current law, revenues earned by a tax-exempt hospital are taxable if the income-producing activity is: (1) a trade or business; (2) regularly carried on; (3) not substantially related to the hospital's performance of its exempt purpose or function; and (4) not carried on by the hospital primarily for the convenience of its own patients. A conclusion that hospital outreach testing falls within this definition is inescapable.

First, it can hardly be denied that a hospital's provision of x-ray services to a nursing home constitutes a "trade or business." The I.R.S. regulations at Section 1.513-1(b) define trade or business as "any activity carried on for the production of income from the sale of goods or performance of services." The fact that a tax-exempt hospital provides a similar service in a manner consistent with the hospital's tax-exempt purpose does not mean that the service, if provided in a different context, does not fall within the definition of trade or business. In the case of the portable x-ray service, the hospital's precise purpose in providing the service is to generate income; thus, the hospital's sale of x-ray services to nursing homes undeniably constitutes a "trade or business."

Outreach testing, as it is practiced by tax-exempt hospitals, also easily satisfies the second criteria; it is "regularly carried on." In determining whether a trade or business is regularly carried on, the IRS looks to the frequency and continuity with which the income-producing activity is conducted; and whether the activity is "pursued in a manner" that is "generally similar" to comparable commercial activities of nonexempt organizations. Hospital outreach testing meets both of these criteria. First, it is systematically and consistently promoted and carried on. NAPXRP members have reported countless instances in which hospitals hold themselves out to nursing homes on a continuous basis and send technicians to perform x-rays for nursing home patients as frequently as the hospitals receive a physician's order. Moreover, tax-exempt hospitals pursue this activity in precisely the same manner that tax-paying portable x-ray providers pursue it: the focus of both tax-exempt hospitals and tax-paying portable x-ray providers is the nursing home market.

Third, the provision of outreach diagnostic x-ray services by tax-exempt hospitals is not generally "substantially related" to their exempt purpose. The IRS regulations explain that a trade or business is substantially related to an exempt purpose when the business activity has a substantial causal connection to achievement of the exempt purpose. Simply put, the business activity must "contribute importantly" to the tax-exempt purpose. Confronted with this test, it becomes clear that the performance of outreach testing is not substantially related, or even marginally related, to the hospital's tax-exempt purpose. According to all court decisions and IRS Revenue Rulings of which NAPXRP is aware, hospitals are granted a tax-exemption to care for their inpatients and their outpatients. Hospitals are not granted an exemption to care for persons who have no relationship whatsoever with the hospital. Yet this is precisely what outreach testing is. There is no connection between the patients and the hospital. The patient does not even see the hospital. In most cases, the hospital does not open a file for such patients.

Although NAPXRP is not aware of any court decisions or revenue rulings that address the particular issue of outreach diagnostic x-ray testing, the IRS has issued revenue rulings considering the performance of outreach diagnostic laboratory testing. At issue in Revenue Ruling 85-110 were the following facts: a tax-exempt hospital received income from laboratory testing that it performed for members of the public who did not otherwise avail themselves of the hospital's facilities; no substantial causal relationship existed between the hospital's exempt purpose and the provision of testing to these patients; and the hospital's provision of testing services to these patients was not carried on primarily for the convenience of the hospital's own patients. In addition, commercial laboratory services identical to those offered by the hospital were available in the area and could be performed in a convenient and timely manner. Confronted with these facts, the Service held that the hospital's provision of laboratory testing services to nonpatients constituted unrelated trade or business.

An identical conclusion is appropriate with regard to the portable x-ray industry. Tax-exempt hospitals are receiving income from providing services to patients with whom the hospital has no relationship; no substantial causal relationship exists between the hospital's exempt purpose and the provision of x-ray services to these patients; the hospitals are not providing portable x-ray services to nursing home patients for the convenience of the hospital's own patients; and tax-paying portable x-ray providers are, in most instances, geographically accessible and capable of furnishing the required x-rays.

Thus, in response to the Subcommittee's question: "To what extent do tax-exempt organizations engage in income-producing activities that are being, or could be carried on, by taxable businesses?", the answer is clear. Not only could the business being conducted by tax-exempt organizations be carried on by taxable businesses, it is carried on by such businesses. In fact, but for the unfair intrusion into the tax-paying portable x-ray providers' market by tax-exempt hospitals, such services would continue to be supplied by those who lawfully supply them: tax-paying portable x-ray providers.

Finally, the income derived from a tax-exempt hospital's outreach x-ray services must be declared unrelated business income because it is not carried on primarily for the convenience of the hospital's own patients. Indeed, such testing bears no relationship whatsoever to the hospital's patients. Both the Supreme Court and the IRS recognize that to qualify as a patient, an individual must be or have been the beneficiary of direct treatment by the hospital or by a program administered by or affiliated with the hospital. In short, there must be a "hands on" treatment link between the individual and the hospital. Yet it is precisely this "hands-on" link that is lacking when a hospital provides outreach testing to nursing home patients.

In conclusion, because the hospital outreach testing meets all four criteria of unrelated business activity, all income generated by it must be taxed as unrelated business income.

While the foregoing analysis dictates that the income derived from a tax-exempt hospital's outreach testing be declared as unrelated business income, public policy warrants the same conclusion. Most portable x-ray services are provided to elderly Medicare beneficiaries, and accordingly, it is the Medicare program that pays for the service. Based on reports from NAPXRP members, it appears that Medicare reimburses a hospital substantially more for the portable x-ray service than it pays a portable x-ray provider. The Medicare program reimburses portable x-ray providers on the basis of their reasonable charges. Over the years, arbitrary limitations based on the charges submitted by free-standing radiologists and payment ceilings such as the inflation-indexed charge have been imposed on portable x-ray providers' charges in order to limit program expenditures. Hospital reimbursement, however, is generally subject to no such limits. The Medicare program reimburses hospitals 80 percent of the costs that they incur in serving Medicare beneficiaries in the hospital outpatient department. To the extent that hospitals include within these costs the costs of acquiring equipment, employing personnel or purchasing supplies used to service the outreach x-ray testing market, a percentage of that cost is reimbursed through the Medicare program. Thus, in response to the Subcommittee's question: "To what extent, if any, do current income-producing activities of exempt organizations relate to Federal budget cuts or other government policies?", NAPXRP replies as follows. When tax-exempt organizations compete with tax-paying commercial entities and the government is thereby deprived of tax revenues it formerly received (and, in the case of Medicare, the federal government is required to pay more for such services than would otherwise be necessary), the income-producing activities of exempt organizations are in direct conflict with federal deficit reduction policies.

The Subcommittee has asked as well: "Do the present-law rules permit unfair competition by exempt organizations? If so, how should the rules be changed?" As I believe my testimony has made clear, NAPXRP believes that the present-law rules, as interpreted and enforced, do in fact permit unfair competition.

To rectify this situation, NAPXRP offers the following suggestions: First, while NAPXRP believes that the business of outreach testing conducted by tax-exempt hospitals is not "substantially related" to a hospital's tax-exempt purpose, NAPXRP submits that this standard is vague and accordingly, difficult to administer. NAPXRP submits that a more precise standard, and one susceptible of ready definition, would be appropriate. Thus, for example, NAPXRP proposes that any tax-exempt organization that engages in any commercial activity whatsoever be subject to the unrelated business income tax. NAPXRP further suggests that the Subcommittee explore the feasibility of imposing a minimum tax that tax-exempt entities engaged in commercial activities could pay in lieu of computing their actual taxes. In the alternative, the Subcommittee might wish to develop a policy pursuant to which any tax-exempt hospital engaged in a minimum-specified amount of commercial activity (i.e., as a percentage of its total operating revenues) would be deemed to be operating for other than tax-exempt purposes.

Second, NAPXRP urges that the current Forms 990 and 990-T are not adequate "to identify the type of income-producing activity, the degree of "relatedness" of an activity to an organization's tax-exempt purpose, and other compliance issues." NAPXRP submits that tax-exempt entities should be required to identify all types of commercial activity in which they engage; it should not be within the organization's discretion to decide those commercial activities that are "related" and those that are not. Moreover, the current forms should be reviewed to determine whether they accurately reflect the total receipts that a hospital realizes from any commercial activity in which it engages. NAPXRP proposes further that a hospital's failure to report all commercial activity might possibly subject the hospital to civil money and other appropriate penalties for misrepresentation. On a related point, NAPXRP notes the possibility that even in those instances in which a hospital declares unrelated business income and files a Form 990-T, there may be insufficient safeguards in the existing regulations to ensure a fair allocation of a hospital's expenses to the unrelated business category. Absent specific Subcommittee or IRS guidelines concerning applicable accounting treatment, a hospital's true profits from its outreach activities may be understated, and accordingly, tax revenues lost.

Finally, NAPXRP suggests that IRS enforcement be strengthened so that tax-exempt organizations that either do not report or mischaracterize their unrelated business income could be readily identified, thus enabling the IRS to take appropriate action against these entities, capture more tax revenues and help turn unfair competition into fair competition.

On behalf of NAPXRP, I would like to thank the Subcommittee for the opportunity to testify on this important issue.

Chairman PICKLE. Thank you, Mr. Gambardella, and all panelists. The Chair recognizes Mr. Schulze for questions.

Mr. SCHULZE. Thank you, Mr. Chairman. I, too, would like to thank this panel, unfortunately, I do have to leave because I have another meeting I must attend.

Mr. Garber, there is one thing in your written testimony that I wanted to question you on. Where you discussed tax-exempt organizations starting and offering a service because none was being provided by private firms, and then as time, and society's need change, you state so might the question of appropriateness change as private enterprise moved in in a similar activity. That perhaps there should be some kind of an incentive for the nonprofit to get out and move on.

That is the first time we have heard that. Would you expand on that just a little bit.

Mr. GARBER. Yes. Because over the years, there has been several things that have gone on that as far as I can see, in my opinion, the UBIT concept basically is not working. Part of it came up already this morning. The way the charter of a tax-exempt organization can be written is so broad, it is hard to come up with an example of anything that would fall outside of it, and then therefore be covered by the UBIT.

Now, having made that statement, nevertheless, we must recognize that there are activities that are quite legitimate for a tax-exempt organization to be involved in, and I am now speaking specifically of the research service activity.

For example, there might be some brand-new instrument that is truly unique. There may be only one-of-a-kind in the United States. It may have developed almost as a prototype instrument, and this, in my opinion, should not only be appropriate but I would think that it would be encouraged because now private capital could not justify getting involved in this brand-new emerging technology.

But we also have to realize that what is unique today is routine tomorrow. The jet engine in 1960 was unique, but a few years later, there were very few propeller airplanes left. So we have to be very careful that we do not cast in stone, in 1987, a particular activity as being appropriate, but not continue to review and review, because as times change society's needs change, and perhaps the uniqueness is no longer there. Such an activity may very well become inappropriate at a later date.

And therefore, tax-exempt organizations, just like any for-profit organization, when the market needs change, then the assets should be redeployed into areas where they are more appropriately needed.

Mr. SCHULZE. Would you use the same parallel in maybe human needs, and say if a YMCA was, or any kind of an organization was performing well in an inner city operation, or extended that out where there was no facility, and then suddenly it built up that you could give them some kind of an incentive to go elsewhere, where there was not——

Mr. GARBER. Yes. I think that, certainly, would be the ultimate in being responsible in terms of a tax-exempt organization, but I cannot help but recall the March of Dimes Program. I may be using these words not quite correctly, but when polio was conquered, they did not start manufacturing a vaccine, and somehow construe such manufacturing to be related to their chartered purposes.

I believe they redirected their energies into birth defects, and if that area should ever be resolved, I would expect that the long 100-year history of that organization—I could almost extrapolate—and there will be some new, emerging area that they would then, again, redeploy their energies.

To me, that is what a responsible nonprofit organization ought to be doing. I have not heard, from the testimony this morning, that that is what is happening in the case of the YMCAs.

Mr. SCHULZE. It is a very interesting concept, and I thank you very much. The committee will certainly look into it.

Mr. GARBER. Thank you.

Chairman PICKLE. Thank you, Mr. Schulze. Now, first let me ask Mr. Hughes this. When you said you have competition from an organization that was set up by local foundations, I am trying to understand what is your competition, who is your competitor, and how is it put together.

When you say "they set up their nonprofit library with a grant from several local foundations", tell me how they did this.

Mr. HUGHES. The organization behind the founding of it is called the West Texas Geological Society. The foundations in town that contributed to it were—if you wanted specific names, I would be glad to pass them on—they contributed in amounts, in most cases, $75,000. I know of three different grants they received in that amount from three different foundations.

Chairman PICKLE. All right. There was a West Texas Geological Foundation, and it——

Mr. HUGHES. No, sir. West Texas Geological Society, just a group of all the geologists in Midland.

Chairman PICKLE. All right. And they formed a nonprofit organization?

Mr. HUGHES. Called The Midland Energy Library. That is the specific entity I referred to.

Chairman PICKLE. And who would be members of that? Private drilling companies, or majors, independents?

Mr. HUGHES. No, sir. All of those——

Chairman PICKLE. Suppliers? Who?

Mr. HUGHES. Anybody—all of the names that you mentioned, yes, but anybody.

Chairman PICKLE. Anybody.

Mr. HUGHES. Being nonprofit under 501(c)(3), they cannot restrict membership to anyone.

Chairman PICKLE. And then that group decided that they would make grants to the library?

Mr. HUGHES. The officers of Midland Energy Library then went out in the community and started knocking on doors, soliciting funds from the various foundations to underwrite the opening of their enterprise.

Chairman PICKLE. So they have set up a business composed of a lot of the private entities throughout that area, a log library, in direct competition to you?

Mr. HUGHES. Yes, sir.

Chairman PICKLE. And do they pay any taxes, do you know?

Mr. HUGHES. They do not.

Chairman PICKLE. All right. Well, then, this is a case where a group of geologists or petroleum-related people set up a foundation and received grants, and have gone into business in competition with you?

Mr. HUGHES. Yes, sir. The only exception I would make to what you said, Mr. Chairman, was, they did not set up a foundation. They just set up the Midland Energy Library. It is not a foundation.

Chairman PICKLE. Well, they set up a 501(c)(3) organization, and they are in business, and, so far as you know, they do not pay any UBIT taxes?

Mr. HUGHES. Oh, I am virtually certain they do not. They were created—their charter is described as a nonprofit organization.

Chairman PICKLE. Now I was interested in the testimony of several of you people here, particularly of Mr. Jones from the Texas Hearing Aid Association from Fort Worth. And now also here is Ms. Cole from Austin, who represents the State association of the ASHA, or the——

Ms. COLE. The national association.

Chairman PICKLE [continuing]. American Speech-Language-Hearing Association. It seems to me like your two testimonies are in direct conflict.

Mr. Jones, are any of your members in Austin being affected by the practices of the ASHA organization, or are any in Fort Worth, or any other place in Texas?

Mr. JONES. No, sir. They are not being affected by the American Speech-Language-Hearing Association that Ms. Cole is president of. Many of our members of the Texas Hearing Aid Association are also members of her association. These are State and national trade associations.

Chairman PICKLE. Well, some of your members belong to her group?

Mr. JONES. Yes, sir.

Chairman PICKLE. Well, now, do you have any opposition to or concern with what Mrs. Cole has said?

Mr. JONES. The only thing that I might—was concerned about—the International Trade Commission study that showed that 1,161,000 hearing aids sold last year in the United States, that approximately 14 to 15 percent of those are sold through nonprofits.

In Texas, we sold a little over 60,000 hearing aids last year in the State. There are 12 Easter Seals that are in direct competition, selling hearing aids on a daily basis against for-profit businesses, and several rehabilitation centers, and our estimates show that they represent close to 15 percent of the market in Texas, now, and it is a growing percentage.

Chairman PICKLE. Well, the organizations that are competing against you primarily are such organizations as the Easter Seal? I guess that is one good example?

Mr. JONES. Pardon?

Chairman PICKLE. The Easter Seal associations?

Mr. JONES. Yes, sir. The Easter Seal Societies of Texas, and the West Texas Rehabilitation Commission in Abilene.

Chairman PICKLE. And you complain that you cannot compete with the Easter Seal Society when they sell hearing aids at a lower price?

Mr. JONES. Yes, sir. We are having problems, especially in West Texas, with the Easter Seal which is part of the West Texas Rehabilitation Center, and they are selling hearing aids—that when they first started, they were selling hearing aids just over cost, and after several years, now, in business, there have been no new businesses. Independent practices go into Abilene since they started this practice, and they are spread into San Angelo and Snyder.

Their hearing aids now are up to over $450 which is more in line with retail, but they are——

Chairman PICKLE. If their prices were in line with retail, would you have any objection?

Mr. JONES. Yes, sir. I would object to their nonprofit status that they have.

Chairman PICKLE. Mrs. Cole, is your organization causing difficulty in the private field?

Ms. COLE. No. My organization is a professional organization and our membership includes people who work both in the tax-exempt sector and in the for-profit sector. Our concern is that we do not see data that indicate that the not-for-profit sector has a big corner on the market, and we are very, very concerned, that for those people who cannot afford hearing aids on their own, that if we essentially eliminate the work done in the public sector, where is that going to leave those people?

Many of the hearing aids dispensed through these nonprofit agencies—Easter Seal, West Texas Rehab, and some others—are dispensed through Maternal and Child Health, which is a hearing aid loan program that the State does. The facility recognizes no gain off the sale of an instrument.

Before any major changes are made, Mr. Pickle, we simply would like to know what the figures are. When you say an Easter Seal Society dispenses *x* number of hearing aids, how many of them are sold on a sliding scale, how many of them are dispensed on behalf of the State? And those data are not there, that we know of.

Chairman PICKLE. We are trying to collect as much of that data as we can.

Ms. COLE. Yes, sir.

Chairman PICKLE. It is difficult to find them. We do not get many volunteers from associations wanting to really tell us about what they are actually doing.

Ms. COLE. We will be happy to help in any way we can.

Chairman PICKLE. I am just wondering, is there any point, at which a nonprofit group should not sell hearing aids, but rather refer them to a private clinic? They provide their services, and they determine somebody needs help. Can we reach a point where they would then refer you to a private organization, rather than sell the hearing aids themselves? Is that a possibility?

Ms. COLE. That is done by some not-for-profit organizations. All do not dispense hearing aids. Some of them do the testing, determine the need, and then refer them to a seller of hearing aids in the private marketplace, and certainly, that, in some instances, has worked out well.

Justification made by some nonprofits about why they have started their own dispensing is based on two points. First of all, when you do the testing, then you send them somewhere else to buy the hearing aid, and then they come back to you for follow-up, some patients, particularly those who are elderly, those who have limited transportation problems, very young children—that discontinuation in services, or that break in services is inconvenient.

And then also, there is a greater complaint that they do not come back for followup services.

Chairman PICKLE. I think it is something that would be desirable. Now at what point do they make a referral, and what point do they want to sell, and how do you coordinate them may be a difficult question, but it is worth consideration.

Have you had any complaints, specifically, Mr. Jones, of people in the State as to organizations underselling you, underpricing you?

Mr. JONES. Yes, sir. Currently, there is a group of dispensers in Dallas, that is having the Attorney General and the State compile the data under the open records law in Texas.

The Aston Center at the Health Science Center at University of Texas—Dallas, opened a retail hearing aid store at the center, and they are selling their hearing aids between $530 to $730.

But they have gone out into the senior citizen centers, and have recruited people to come into this Health Science Center to purchase their hearing aids, and we felt like this was in direct violation of, and unrelated to what the Aston Center was originally set up to do with the university consultants—the professors and teachers there, the doctors on staff. We do not understand why this center had to go into the retail hearing aid business.

And the four State agencies in Texas are covering the poor and indigent, and the handicapped. The Texas Rehabilitation Commission will buy hearing aids for anyone 16 years of age up to 65, up to retirement, to rehabilitate them back into the work force.

The Health Department buys hearing aids from birth through 20 years of age for children. The Medicaid Department pays for the indigent individuals in Texas, and most all private businesses are signed up with all these State agencies, and they are meeting the needs of that low-income and indigent population throughout the State.

We fail to see why 25 or 30 of these nonprofit, Easter Seals, and centers, need to be involved in the retail hearing aid business under the——

Chairman PICKLE. Well, we have had testimony from the Easter Seal groups, and I think it is not unfair to just say they need the income to carry on their public-service activities, and they are therefore engaged in it. But they do not pay any UBIT, and that is what we are trying to understand here.

And we are trying to ascertain if your people are going to be put out of business because of it. Now, Mr. Gambardella notes a long case here, that these hospitals, or nursing homes, are actually selling their x ray examinations or services at a cheaper price.

At least you give me three or four examples of where different members had reported that the nursing homes were using a hospital facility. Am I correct in assuming that the nursing homes are using the hospital units because of price?

Mr. GAMBARDELLA. No, sir. As a matter of fact, the prices, or the—under part A billing, the hospitals receive more money as they bill Medicare directly, than we do as providers under part B, billing under part B.

Chairman PICKLE. Well, I am trying to ascertain if you are saying that the nursing homes are using the hospital units, which have tax-exempt status, because they get it at a lower cost. It has to be; otherwise, they would not be using those services, would they?

Mr. GAMBARDELLA. You would assume so. As reported by many of our members, hospitals do in fact place portable x ray units in the facility of the nursing homes under the conditions of portable providers.

We cannot, as portable x ray providers, place equipment in the nursing home facilities. We in fact have to transport this equipment to and from. The nursing homes engage it, assemble it, bring it to the bedside, and then disengage it and carry it away. The rules are not the same for our association as it is for the hospitals.

Chairman PICKLE. Has your association, or any members of your association, actually brought suit against any of the homes for this undercutting of pricing?

Mr. GAMBARDELLA. No, sir. No. We are not at all claiming that they are undercutting our prices. What we are saying is that as the nonprofit hospitals enter this field, they are competing with us by in fact using student x ray technicians where we use technicians who have to meet certain qualifications.

Chairman PICKLE. Well, I understand that. But it seems to me, what you are trying to say is that because they can use students, and because they have a tax-exempt status, they can actually sell their x ray services at a lower price than your organization can provide.

I would think that price would be a part of it, but are you saying that price does not——

Mr. GAMBARDELLA. No, sir. The hospitals bill under part A, Medicare. Under part A, Medicare, the hospitals receive more money from the Medicare program than we in fact do under part B.

Under the part B provision of billing Medicare, the price structure is governed by Medicare, and price does not enter into this at all. What does enter into it is that the hospitals can exercise lesser expenses to them. They can exercise student technicians where we cannot.

They can place equipment on nursing home property, which we cannot. They have the leverage within the nursing homes that we do not have. And as far as the taxes, sir, they do not pay taxes, and we are tax-paying entities.

Chairman PICKLE. Well, I thank you. I appreciate the testimony of the panel. I don't have any other questions. Mr. Flippo, do you have any questions?

Mr. FLIPPO. No questions, Mr. Chairman.

Chairman PICKLE. Well, we thank you very much for your testimony.

The next panel consists of John Satagaj, Stephen Feldman, and Alice Gallagher Reed. Those three individuals will take their places at the witness table.

Our first witness is John Satagaj—is that correct?

Mr. SATAGAJ. That is correct, Mr. Chairman.

Chairman PICKLE [continuing]. Who represents the Small Business Legislative Council. Then, Stephen Feldman on behalf of the Association of Business Publishers. Mr. Feldman. And then Mrs. Reed representing the California Business Coalition.

Mr. Satagaj, if you will proceed first.

STATEMENT OF JOHN S. SATAGAJ, PRESIDENT, SMALL BUSINESS LEGISLATIVE COUNCIL

Mr. SATAGAJ. Thank you, Mr. Chairman. My name is John Satagaj, and I serve as the president of the Small Business Legislative Council, a permanent independent coalition of 90 trade and professional associations that share a common commitment to the future of small business.

Our member associations represent the interests of over 4 million small businesses in manufacturing, distribution, retailing, construction, agriculture, and professional and technical services.

I cannot say the problem of unfair competition is a problem for all small businesses. Certainly not all of my member associations have a direct concern.

I can say, however, the problem is uniquely a small business problem. Among the industries identified by our organization that have a problem with unfair competition are food services, testing laboratories, retail sale of books and computers, audiovisual services, travel, recreation, nurseries—that is trees and shrubs—day care, hearing aids, veterinarians, consulting engineers, medical equipment suppliers, specialty advertisers, hotels, bus operators, printing, laundry, construction, and data processing.

The problem is a uniquely small business problem for two principal reasons. One is that most of the activity takes place in the service industries, and at this time the service industries are dominated by small businesses.

The second reason is that competition takes place on a geographic localized basis, and therefore it is small business versus one institution.

Our competitors are primarily 501(c)(3) organizations. Universities are multidimensional competitors, competing against a number of different for-profit businesses such as laboratories, the travel industry, audiovisual, and data processing.

Health care is probably the next largest area of competition. Third would be travel, and their competitors in the nonprofit sector come from a hodgepodge of different institutions.

What are the specific effects of unfair competition? When I first got involved in this area, I started out with the premise that tax exemption led to price-cutting, and a price advantage, and that the consumer did benefit, in a way, in terms of getting a product at a lower price.

Over the years, and having talked to many small businesses, I have learned that that is not really the case, although it does happen in some instances. What happens is that the tax-exemption does provide a subsidy to sustain entry into a market, and that the aura of nonprofit competition allows a nonprofit entity to win new business.

And while it is true that an entity could exist without tax exemption, I would venture to say that very few would continue, nor would postal rate subsidies, or local and State property tax exemptions flow to these nonprofits, nor would they operate without the tax exemption.

I believe Mr. Rudney, the other day, spoke about this at great length, and I think that testimony should be viewed in that light. I would like to finish my brief remarks by addressing Mr. Chapoton's recommendations on the first day of hearings.

I must say that the recommendations are very positive in nature. We are pleased that the Department has recognized there are problems in this area. However, I must say that we were disappointed with Mr. Chapoton's remarks in that he did not go far enough in specifying recommendations for action.

He has identified the problems. I say this with tongue in cheek and in respect to the room I am in, the Department of Treasury said in the tax-reform debate that they did not have enough data on the impact on small business, but they went ahead and proposed a lot of things that were very detrimental to small business.

In this case the Department is saying they have no data and they are not going to go ahead. I fail to see the difference, and, as I said, this is strictly tongue in cheek.

Mr. Chapoton speaks, particularly in one area, about the conceptual merit of the current law. We would agree with Mr. Chapoton. The language in current law does have conceptual merit. The problem is, however, that the courts have rendered it meaningless, and we do not believe there is anything we can do, short of Congress getting involved again, and straightening out what was once good language, and putting it back on course.

For these reasons, we are here advocating that Congress become involved again in this issue, and move forward to clearly define in what activities a nonprofit should be involved.

Thank you, Mr. Chairman.

[The statement of Mr. Satagaj follows:]

Testimony of

John S. Satagaj
President

Small Business Legislative Council

My name is John S. Satagaj and I am President of the Small Business Legislative Council. The Small Business Legislative Council (SBLC) is a permanent independent coalition of ninety trade and professional associations that share a common commitment to the future of small business. Our members represent the interests of over four million small businesses in manufacturing, retailing, distribution, professional and technical services, construction, and agriculture. A list of our members is appended to this statement.

I would like to devote my testimony to two specific aspects of the unfair competition by nonprofits issue-why it is a "small business" issue and why we need to revisit the manner in which we regulate the nonprofit sector. SBLC is a member of the Business Coalition on Fair Competition (BCFC) and we wish to associate our organization with the testimony of BCFC. It provides an excellent framework for understanding this issue. Likewise, several members of SBLC have submitted individual statements on behalf of their industries. They can tell the firsthand story of the harsh reality of unfair competition in the marketplace, we will not attempt to recount their concerns here.

As I am sure many will mention today, the issue of unfair competition by nonprofits emerged as the third highest priority at the 1986 White House Conference on Small Business. The story of the Conference however is the intensity of the interest in this issue within the small business community. I had the privilege of serving in a formal capacity in the proceedings of the 1986 Conference and the predecessor conference in 1980, and have been a first hand witness to the growing concern of small business in this matter. At the 1980 Conference, this issue was discussed only in conjunction with a companion issue, direct competition by government and did not receive any attention in the final fifteen top recommendations of the Conference. We were only beginning to understand the scope and nature of the problem at that time.

By the 1986 Conference, however, unfair competition had reached epidemic proportions. Some of the most lively debates at the 1986 Conference centered on this issue. What I found most remarkable was the diversity of the businesses that share this problem. More often than not, we heard the refrain, "I have the same problem, but I did not think anybody else did, and I did not know what to call it." Among the industries identified by the participants were: food service, testing laboratories, retail sales of books and computers, travel recreation, nurseries, day care, hearing aids, veterinarians, blood banks, consulting engineers, medical equipment suppliers, pencil makers, specialty advertisers, hotels, bus operators, printing, construction, laundries, janitorial services, waste hauling, electrical, plumbing and heating contracting to name a few.

One of the realities of this problem is that the problem tends to be local in nature, that is competition takes place in defined geographic markets on a case by case basis. As a result, we often hear the phrase, "I did not think anybody else had this problem." We do not believe the lack of dramatic national statistics should be confused with the intensity and magnitude of the problem. It is significant in scope.

The prominence of this issue at the White House Conference on Small Business reflected the awareness of unfair competition and its impact on small business. It should come as no surprise to learn of small business' interest in unfair competition. The ability to compete on a level playing field is of paramount importance to smaller firms. Small business does not ask government for much but it does expect government to provide for fair competition. Our organization has a long history of pressing for the vigorous enforcement of antitrust laws for many of the same reasons which prompted us to appear here today.

Throughout our economic history we have used the term unfair competition portray a multitude of problems. In recent years it has been used most frequently in conjunction with three specific problems which share a common denominator. We use the term to describe the situation in which the government conducts commercial activities that it could obtain from the private sector. These activities range from custodial services to nursery farming. The second type of unfair competition is competition from regulated monopolies. This competition results when utilities use rates to subsidize heating and cooling construction "subsidiaries". The third kind of unfair competition occurs when nonprofits provide goods and services to the public in direct competition with private, for-profit firms. Each of these unfair competition problems constitutes a significant shift in economic activity. It has been estimated, for example, that government competition with the private sector costs the taxpayers $2 to $3 billion annually in the federal budget. The common denominator in all three situations is that the unfair competition occurs at the expense of small business.

At our own 1987 issues conference, this issue emerged the sixth priority, we said:

> FAIR COMPETITION. In order to protect small businesses, and consumers, from damaging levels of unfair competition, federal, state and local laws, regulations and policies should:
>
> a. Prohibit unfair competition in which non-profit tax-exempt organizations use their tax-exempt status and other advantages in selling products and services also offered by small businesses.
>
> b. Prohibit direct, government-created competition in which government organizations perform commercial services.
>
> c. Prohibit government sanctioned monopolies, such as utilities, from using their monopoly resources to compete in other markets.

These goals should be achieved in, but not limited to, the following ways:

> Non-profits: Tax-exempt entities should not be permitted to use their tax status or postal rates to compete with commercial providers of products and services. Non-profit organizations receiving government grants and contracts, including

> Federally Funded Research and Development Centers, should be prohibited from using federal dollars to compete with products and services provided by the private sector. Non-profits engaging in commercial activities should be prohibited from doing so while enjoying exemption from government regulations such as antitrust laws, worker's compensation, and health and safety rules.
>
> Governments: New laws at all levels, particularly at the federal level, should require strict government reliance on the private sector for performance of commercial-type functions. When cost comparisons are necessary to accomplish conversion to private sector performance, laws must include provision for fair and equal cost comparisons. Funds controlled by a government entity must not be used to establish or conduct a government operated commercial activity on U.S. property. Further, public funds extended by federal, state, and local government must be utilized, to the extent feasible, to contract for goods and services from the private sector.
>
> Utilities: Government regulated utilities should be prohibited from using their government favored position to compete in markets already served by small businesses.

Several factors contribute to make unfair competitor by nonprofits a small business problem. Most prominent among them is the fact that small businesses dominate the service sector. Easy of entry, low capital costs, and a premium on human resources make the service industries ideal spawning grounds for small businesses. Although it is a little like the debate over what came first, the chicken or the egg, the expanding role of small business in the service sector coincides with the movement of our economy towards a service based economy. Its hard to say what came first, but the bottom line is small business is the service sector. At the same time the nonprofit community is best suited for expansion into service markets. Universities, hospitals and other nonprofits have the facilities and the personnel, it is only a matter of applying a little creative foresight to develop new markets for nonprofits. The reasons for their expansion are obvious-declining revenues, increased costs and excess capacity. From that perspective its hard to find fault with the nonprofits; we would expect any small business to apply the same business strategy, the only problem is that the nonprofit applies the strategy without economic responsibilities.

Another factor contributing to the disproportionate impact on small business is the fact competition takes place in local markets. Professional and technical services, on the whole, do not lend themselves to national marketing strategies. Unlike a product which can be placed in the stream of interstate commerce, service does require "personal" delivery and thus competition generally pits one nonprofit against one local segment of the for-profit community.

The problem is that we have an economic sector which is turning a considerable "profit" at the expense of the taxpayer and the small business community. At one time charitable entities had clear purposes and clear means of support. Now it is an industry with unrestrained growth. It is unregulated for all intents and purposes. Subchapter F of the Internal Revenue Code includes 25 specific categories of exempt organizations. Nearly half of all tax-exemptions are granted to organizations under the criteria of Code Section 501(c)(3) for religious, charitable, scientific or educational purposes. It is these 501 (c)(3) organizations that generate most of the competition with for-profits. Section 501(c)(3) organizations are generally service oriented, that is they generate revenue by providing services for a fee, and thus are more likely to compete for business. Hospitals and educational organizations account for 36 percent and 17 percent of total tax-exempt revenue, respectively. Consider the fact that over 850,000 nonprofits hold a federal tax exemption. Only 350,000 filed the Form 990. Of that number only 27,000 filed form 990-T's reporting income from unrelated business. They reported only $27 million in unrelated income, an insignificant amount considering that it is estimated the nonprofit sector represents 9 percent of our GNP, or 300 billion dollars. Further, the IRS has only 500 agents assigned to this area.

The reason the unrelated business income tax is ineffective is that it relies on determinations of motive in the already gray area of relatedness. It is a gray area because nine times out of ten, expansion is going to be built on existing resources and talents and thus will, in the commonly accepted sense, almost always be related. The macaroni factory cases are the exceptions rather than the rule. The presumption in current law and enforcement is that the purposes comes first, and the nature of the activity second. The Presbyterian & Reformed Publishing case (79 TC 1070 (1982), rev'd 743 F.2d 148 (1984)) illustrates this most graphically.

The solution is to reverse the logic. First, let us identify what are commercial activities and then permit the nonprofit to demonstrate circumstances which would warrant continued performance of the activity. If any activity resembles a commercial activity it should be taxed like one. In particular, if any activity generates a substantial excess of revenue over expenses and if there is for-profit competition, the activity should be taxed as commercial. If the tax-exempt organization chooses to pay the tax then it should be permitted to carry on the function. Our objective is fair competition, not the elimination of competition. We recognize the need for some flexibility and would make the test a rebuttable presumption. The non profit could then demonstrate the need for its commercial services in the community.

Philosophically, the argument goes that absent a profit motive, the nonprofit is more likely to provide the consumer a better service. We would assert that competition by small business has consistently produced a better product at a better price. Second, we believe the competition test is important. One of the rationales given for the existence of nonprofits is the public goods theory, that is, they provide services the government would otherwise be required to supply. The existence of competition would seem to demonstrate that there is no need for a public subsidy. As the court said in Utah City v. Intermountain Health Care (709 P.2d 265) "Neither can we find on this record that the burdens of government are substantially lessened as a result of the [nonprofit's] provision of services... Indeed it might be argued that for-profit hospitals relieve a greater portion of the public 'burden' because they provide medial care without public subsidy."

Let me make it clear that we support the role of nonprofits in our society. Let me also make it clear that the universe of nonprofit unfair competitors is small. We acknowledge the importance of the independent nonprofit sector and its essential contributions in education, basic research, and charitable endeavors. We are particularly proud of the participation of our small businesses in charitable endeavors. Universities educate the highly trained engineers, scientists and other professionals needed for the jobs of the future. Nonprofit trade and professional associations promote professional and ethical conduct as well as improvements in the quality of goods and services. Volunteerism is very much a part of our way of life in this country. The balance between self reliance and the common good makes our economy unique. Small business is a vital component of volunteerism. Small business owners are leaders in their community. The poster in the local appliance store heralding the next bake sale and time spent on the board of the local hospital represent the spirit of volunteerism, and they serve to illustrate the pervasive and integral role of small business in local charitable endeavors.

It is not a comfortable position for small business to challenge traditional notions of charitable endeavors. It is after much discussion and debate we do so. In the end, however, we come to the unescapable conclusion that the costs to small business and the economy have become too great whenever nonprofits can conduct commercial activities without restraint. We believe the revenue raising activities of nonprofits can be channeled into appropriate methods without jeopardizing the future of volunteerism. Thank you Mr. Chairman.

Members of the Small Business Legislative Council

Alliance of Independent Store Owners and Professionals
American Association of Nurserymen
American Consulting Engineers Council
American Council of Independent Laboratories
American Dental Trade Association
American Electronics Association
American Machine Tool Distributors Association
American Society of Travel Agents, Inc.
American Sod Producers Association
American Subcontractors Association
American Textile Machinery Association
American Trucking Associations, Inc.
American Warehousemen's Association
Architectural Precast Association
Associated Landscape Contractors of America
Association of Physical Fitness Centers
Association of Small Business Development Centers
Automotive Service Association
Automotive Warehouse Distributors Association
Building Service Contractors Association International
Business Advertising Council
Chicago Gift Show Inc.
Christian Booksellers Association
Dental Dealers of America, Inc.
Direct Selling Association
Electronic Representatives Association
Florists' Transworld Delivery Association
Helicopter Association International
Independent Bakers Association
Independent Bankers Association of America
Independent Insurance Agents of America, Inc.
Independent Medical Distributors Association
Independent Sewing Machine Dealers Association
International Association of Refrigerated Warehouses
International Bottled Water Association
International Communications Industries Association
International Franchise Association
International Reciprocal Trade Association
Jewelers of America
Latin American Manufacturers Association
Machinery Dealers National Association
Manufacturers Agents National Association
Mechanical Contractors Association of America, Inc.
Menswear Retailers of America
National Association for the Self-Employed
National Association of Aircraft and Communication Suppliers
National Association of Brick Distributors
National Association of Catalog Showroom Merchandisers
National Association of Chemical Distributors
National Association of Development Companies
National Association of Home Builders
National Association of Investment Companies
National Association of Manufacturing Opticians
National Association of Personnel Consultants
National Association of Plumbing-Heating-Cooling Contractors
National Association of Realtors
National Association of Retail Druggists
National Association of Small Business Investment Companies
National Association of the Remodeling Industry
National Association of Truck Stop Operators
National Association of Women Business Owners

-more-

National Candy Wholesalers Association
National Chimney Sweep Guild
National Coffee Service Association
National Council for Industrial Innovation
National Electrical Contractors Association
National Fastener Distributors Association
National Grocers Association
National Independent Dairy-Foods Association
National Moving and Storage Association
National Office Products Association
National Parking Association
National Precast Concrete Association
National Shoe Retailers Association
National Society of Public Accountants
National Tire Dealers & Retreaders Association
National Tooling and Machining Association
National Tour Association
National Venture Capital Association
Opticians Association of America
Petroleum Marketers Association
Printing Industries of America, Inc.
Retail Floorcovering Institute
Small Business Council of America, Inc.
Smaller Manufacturers Council
Society of American Florists
Specialty Advertising Association International
United Bus Owners of America
Web Sling Association

Mr. **Flippo** [presiding]. Thank you. Mr. Feldman.

STATEMENT OF STEPHEN FELDMAN, COUNSEL, ASSOCIATION OF BUSINESS PUBLISHERS

Mr. **Feldman**. Thank you. I am testifying on behalf of the Association of Business Publishers. That is a press association of 600 leading trade and business periodicals.

Those are for-profit tax-paying journals which publish wanted information to professionals in business, industry, science, and medicine. They include companies such as Capital Cities/ABC, Cahners Publishing, McGraw-Hill, Harcourt, Brace, Jovanovich, Hayden Publishing, and many other distinguished publishers.

For over 30 years, ABP has been a strong voice for fair competition between tax-paying periodicals and tax-exempt publications. In 1969, ABP was the leading voice before this committee when the tax-reform act was being considered for the enactment of the UBIT as it would apply to advertising. Last year, ABP alone stood up with IRS in the U.S. Supreme Court, when it submitted an amicus curiae brief in the *American College of Physicians* case.

In that case, the Supreme Court stated that the UBIT does apply to the advertising income of tax-exempt organizations, many of which, I might add, filed briefs in that court. The briefs stated that because they were educational organizations, their advertising also was educational and should be tax exempt. The Supreme Court unanimously disagreed.

As a practical matter, and with deference to the prior witness, we would say it is not just small business where this problem exists. It does exist there, of course; it also exists throughout all free enterprise activity. Unfortunately, all for-profit publications have to compete for readership and advertising with all kinds of tax-exempt publications, whether it be in the medical, chemical, building construction, or any professional, or consumer area.

And yet despite the reaffirmation of the tax on advertising by the Supreme Court, nonprofit publishers, it should not be forgotten, still do enjoy an enormous benefit over taxpayers: That is tax-free circulation income, and the magnitude of the benefit can be realized just by taking one example.

The National Geographic Society, with its circulation of National Geographic of 10.7 million readers per month, and a membership per circulation of $14.40 out of membership dues, receives $154 million per year, tax-free, of circulation income.

And National Geographic is not shy about promoting its virtues as an advertising medium. We have attached to our written testimony an advertisement from Advertising Age, the leading trade journal of advertising. There, the National Geographic says, "You can reach 5,043,000 professional managerial readers at home with National Geographic every month". That is 1,057,000 more than "Time", 2,374,000 more than Newsweek, at a much lower cost. That is the big time indeed.

And according to the June 22 New York Times, the National Geographic has now started up another publication, National Geographic Traveller. In commencing this National Geograhic is now suing Conde Nast, a leading for-profit publisher, because Conde

Nast has a publication called Conde Nast Traveller. So National Geographic is trying to get that area of publishing for itself as well.

Our written testimony has more data, also, about the Smithsonian Magazine, similar to what I have just cited. There is $36.8 million in tax-exempt income there, and aggressive advertising by the taxpayer-supported Smithsonian as well.

Now, the main current problem, aside from what we have just cited, are ongoing tax cases where organizations like the American Medical Association, the American Hospital Association, and others, are trying to use IRS accounting regulations in this area, which are extremely complicated, to avoid paying taxes.

And they are coming up with tax devices which range from $2 a year subscription prices for distinguished journals, like the Journal of the American Medical Association, to unsubstantiated claims that the membership income of organizations like these do not really flow to through the publishing activities of these organizations.

The bottom line of all this accounting complexity is, a claim that nonprofit publications should pay no taxes, and these cases go on for years in the courts.

This is the opposite of what this committee stated in 1969 when it directed IRS to promulgate effective accounting regulations concerning advertising, because this committee feared that, accounting regulations could result in the tax avoidance.

Thus, ABP recommends that where a tax-exempt publication carries advertising, that both its advertising and circulation income be taxed. A tax-exempt organization does not have to carry advertising. If it does, it should not receive any tax-free benefit not otherwise available to taxpayers.

The exemption of circulation income of tax-exempt organizations is discriminatory, because it implies that somehow, the editorial content of a tax-exempt publication, whether it be Ms. Magazine, the Smithsonian, Harper's—those are all nonprofits, which many people may not realize—are in some way more valuable than the editorial content of taxpaying publications, whether it be Time, Newsweek, Aviation Week and Space Technology, or whatever.

This whole thing raises serious constitutional and public policy questions, and therefore we respectfully recommend to the subcommittee that it consider a proposal to tax all publications which carry advertising, on both their circulation and advertising income. Thank you.

[The statement of Mr. Feldman follows:]

STATEMENT OF ASSOCIATION OF BUSINESS PUBLISHERS BEFORE THE HOUSE WAYS AND MEANS COMMITTEE, SUBCOMMITTEE ON OVERSIGHT, CONCERNING THE UNRELATED BUSINESS INCOME TAX

The Association of Business Publishers (ABP) is the association of over 600 leading trade and business journals. These are for-profit, tax-paying periodicals which publish needed information to professionals in business, industry, science and medicine. A copy of the membership directory of ABP has been provided to the Subcommittee and we ask that it be included in the hearing record.

A few examples of ABP members and the periodicals they edit include American Broadcasting Companies, Inc., publishers of Hardware Age and Motor/Age; Cahners Publishing, publisher of The American Journal of Medicine, Professional Builder, and Publisher's Weekly,; Harcourt Brace Jovanovich, publisher of Communications News, and Modern Medicine; Hayden Publishing Company, publisher of Electronic Design and Personal Computing; International Thomson, publisher of Drug Topics and Medical Economics; McGraw-Hill, Inc., publisher of Aviation Week and Space Technology and Chemical Week; PennWell Publishing, publisher of Laser Focus and Oil and Gas Journal; and Penton Publishing, publisher of Machine Design and Progressive Architecture.

For over 30 years, ABP has been a strong voice for fair competition between tax paying periodicals and non-profit, tax-exempt publications. In 1969, ABP appeared before this committee and before the Senate Finance Committee to urge that UBIT apply to advertising. Last year, ABP stood up for free enterprise when it submitted an amicus curiae brief to the Supreme Court in the American College of Physicians case. In that case, the Supreme Court agreed with ABP and with IRS that the UBIT does apply to advertising income of non-profit organizations. The Court rejected arguments by nonprofit organizations that their advertising was "educational" and should be tax-exempt.

In practically every field of publishing, for-profit publications have to compete for readership and advertising with tax-exempt publications. For example, ABP medical publications like American Journal of Medicine have to compete in the marketplace with the Journal of the American Medical Association and with the Annals of Internal Medicine, published by the American College of Physicians. Chemical Week, has to compete with the tax-exempt Chemical and Engineering News, published by the American Chemical Association. Professional Builder, competes with National Building News, published by the National Association of Home Builders. Similar examples abound in both business and consumer publishing.

Despite last year's re-affirmation of UBIT by the Supreme Court, non-profit publishers still enjoy an enormous benefit over their tax paying competitors. That benefit is tax free circulation income. In other words, that portion of an organization's membership dues used to publish a periodical is tax free income, even if that periodical carries advertising.

The magnitude of this benefit can be realized when we consider the example of the National Geographic Society, publisher of National Geographic, which has a circulation of approximately 10.7 million readers per month. Membership dues to the Society are $18 a year, of which $14.40 are allocated as a subscription to National Geographic. Thus, the Society realizes $154 million per year, tax-free, from its circulation income.

Attached is an advertisement which the National Geographic Society recently placed in Advertising Age, the leading advertising trade publication. The ad states: "You reach 5,043,000 Professional/Managerial readers at home with National Geographic every month. That's 1,057,000 more than Time, 2,374,000 more than Newsweek--at a much lower cost."

And, according to the June 22 New York Times, the National Geographic Society has recently begun to publish another publication called National Geographic Traveller. The Society is suing the for-profit publisher Conde Nast for publishing a magazine named Conde Nast Traveller. Obviously, the National Geographic Society considers Conde Nast a competitor.

Likewise, Smithsonian magazine aggressively solicits advertising and circulation income. A Smithsonian advertisement which recently appeared in Advertising Age stated that the 2.3 million subscribers of the Smithsonian have an average annual income approaching $58,000. The text of the ad reads: "But their curiosity doesn't end with our articles. With an average annual income approaching $58,000, they're just as interested in what you have to sell." Smithsonian membership is $20 per year, of which $16 is allocated as a subscription to Smithsonian magazine. Smithsonian magazine generates $36.8 million in tax-exempt subscription income.

The main current problem we see in enforcement of the unrelated business income tax as it concerns publishing is the development in recent years of sophisticated accounting tax avoidance devices by tax-exempt publications like the Journal of the American Medical Association and Hospitals, published by the American Hospital Association. These devices range from stating artificially low subscription prices (e.g. $2.00 per year for JAMA) to unsubstantiated claims that membership income does not flow through to the publishing activities of non-profit organizations.

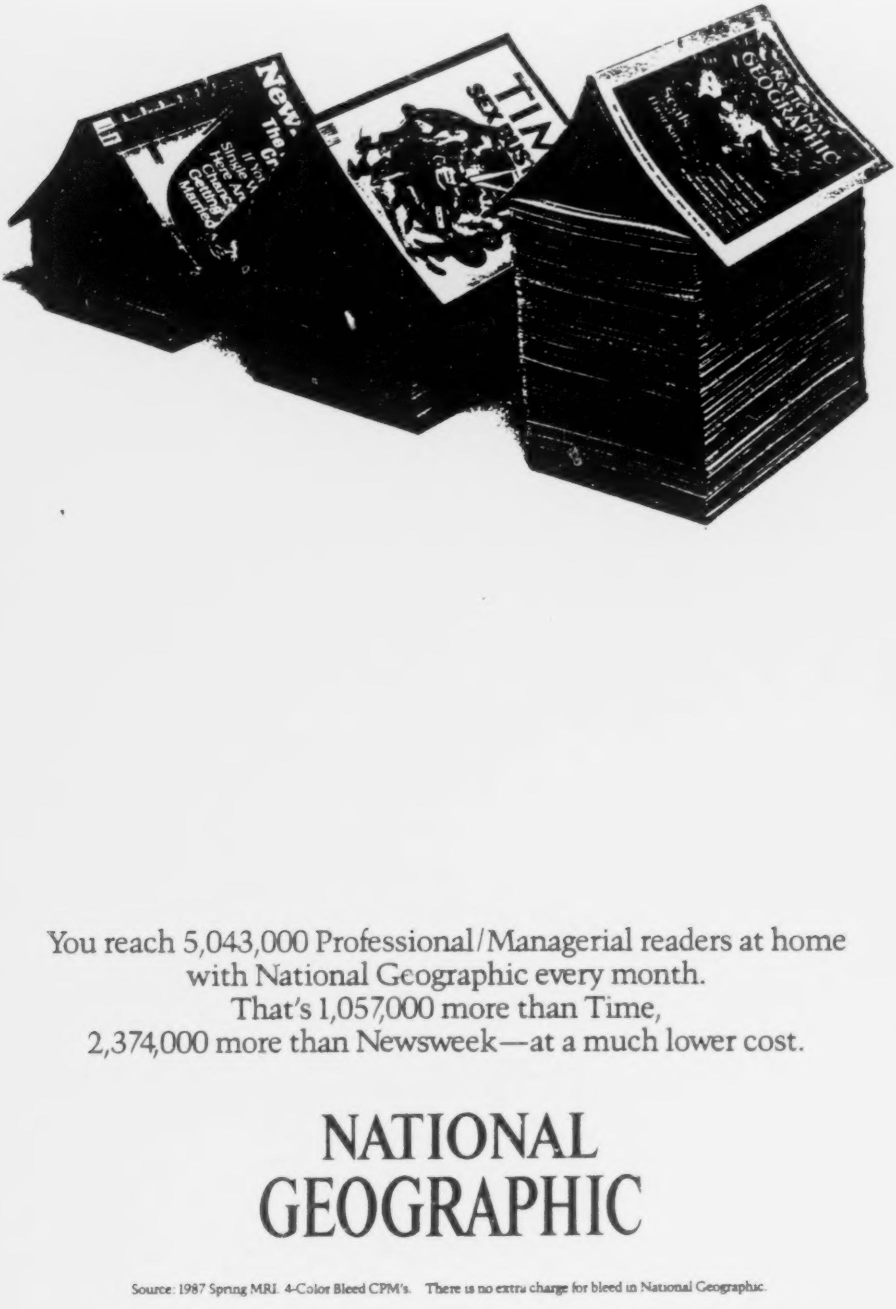
Non-profit organizations have filed lawsuits based on these devices. These cases take years in the courts to resolve. Treasury regulations designed to collect taxes have been turned on their heads to promote tax avoidance. Tax-exempt organizations exploit these loopholes in complex regulations to avoid paying the UBIT, the opposite of this Committee's desire in 1969 that non-profit publications which carry advertising pay taxes.

ABP thus recommends that where a tax-exempt publication carries advertising, that both its advertising and circulation income should be taxed. A tax-exempt organization does not have to carry advertising. If it does, it should not receive any tax-free benefits not otherwise available to taxpayers.

Indeed, exempting circulation income of non-profit publications is discriminatory because there is an implication that the editorial content of a tax-exempt publication is in some way more valuable than the editorial content of a tax-paying publication. This raises serious constitutional and public policy questions.

These complexities can be resolved by taxing all periodicals which carry advertising equally, which is consistent with the basic purpose of the UBIT, that is the elimination of unfair competition.

Advertising Age, June 8, 1987

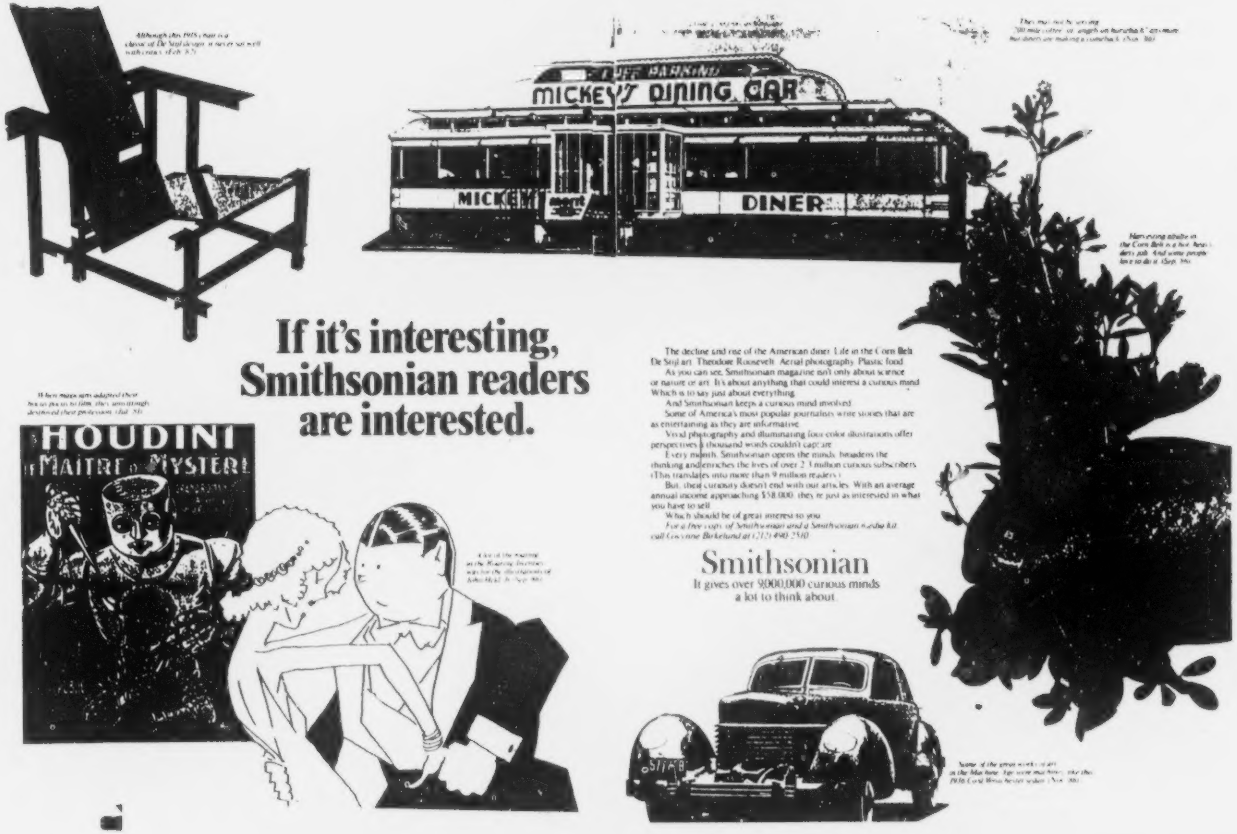


You reach 5,043,000 Professional/Managerial readers at home
with National Geographic every month.
That's 1,057,000 more than Time,
2,374,000 more than Newsweek—at a much lower cost.

NATIONAL
GEOGRAPHIC

Source: 1987 Spring MRI. 4-Color Bleed CPM's. There is no extra charge for bleed in National Geographic.

Advertising Age, June 8, 1987



Although this 1918 chair is a classic of De Stijl design, it never sat well with critics. (Feb. '83)

They may not be serving "100 mile coffee" or "eggs on horseback" any more, but diners are making a comeback. (Nov. '86)

Harvesting alfalfa in the Corn Belt is a hot, heavy, dirty job. And some people love to do it. (Sep. '86)

When magicians adapted their hocus-pocus to film, they unwittingly destroyed their profession. (Jul. '85)

If it's interesting, Smithsonian readers are interested.

A lot of the magic in the Roaring Twenties was in the illustrations of John Held Jr. (Sep. '86)

The decline and rise of the American diner. Life in the Corn Belt. De Stijl art. Theodore Roosevelt. Aerial photography. Plastic food.

As you can see, Smithsonian magazine isn't only about science or nature or art. It's about anything that could interest a curious mind. Which is to say just about everything.

And Smithsonian keeps a curious mind involved.

Some of America's most popular journalists write stories that are as entertaining as they are informative.

Vivid photography and illuminating four-color illustrations offer perspectives a thousand words couldn't capture.

Every month, Smithsonian opens the minds, broadens the thinking and enriches the lives of over 2.3 million curious subscribers. (This translates into more than 9 million readers.)

But, their curiosity doesn't end with our articles. With an average annual income approaching $58,000, they're just as interested in what you have to sell.

Which should be of great interest to you.

For a free copy of Smithsonian and a Smithsonian media kit, call Gwynne Birkeland at (212) 490-2510.

Smithsonian
It gives over 9,000,000 curious minds
a lot to think about.

Some of the great works of art in the Machine Age were machinery, like this 1936 Cord Westchester sedan. (Nov. '86)

ASSOCIATION OF BUSINESS PUBLISHERS
MEMBER ROSTER
MARCH 1987

ABP is often thought of as speaking for the entire business press, and it willingly accepts this obligation. Therefore, it is sometimes overlooked that not all business publications are eligible for ABP membership. To be elected, a publication must meet the association's rigid membership standards:

* It must be audited by an independent, nonprofit, tripartite auditing organization such as ABC or BPA;

* It must be independently owned and tax-paying, in the true spirit of a free press;

* It must adhere to ABP's Code of Publishing Practice, which places the interest of the reader first.

ABP publications represent the best in their particular fields. Similarly, ABP associate members, who espouse the same standards as publishing members, are acknowledged to be the leaders in their respective fields.

As a service, therefore, ABP is pleased to present this roster of members. It is divided into three sections:

* Part One lists all member publishing companies in alphabetical order, together with the names of their ABP voting representatives, principal contacts or ABP directors; and their audited specialized business publications.

* Part Two lists associate member companies, which are suppliers to the publishing members; and lifetime members.

* Part Three groups member publications by their primary SRDS classification and lists them alphabetically within class.

In the first and third parts, international and domestic members are listed separately. All listings reflect ABP membership as of February 1987.

Association of Business Publishers
205 East 42nd Street, New York, NY 10017
212/661-6360

ABC PUBLISHING
(American Broadcasting Companies, Inc.)
1330 Avenue of the Americas
New York NY 10019
(212)887-7777
Robert G. Burton-President

CHILTON COMPANY
Chilton Way
Radnor PA 19089
(215)964-4000
Lawrence A. Fornasieri-President/CEO

Automotive Industries
Automotive Marketing
Commercial Carrier Journal
Distribution
Electronic Component News
Food Engineering/North American Edition
Hardware Age
IAN/Instrumentation & Control News
I&CS/Industrial & Process Control Mag.
Indl Maintenance & Plant Operation
Industrial Safety & Hygiene News
Iron Age
Iron Age/Metals Producer
Jewelers' Circular-Keystone
Motor/Age
Owner Operator
Product Design & Development
Review of Optometry

HITCHCOCK PUBLISHING COMPANY
Hitchcock Bldg.
Wheaton IL 60188-2292
(312)665-1000
Loren M. Walsh-Vice Pres./Gen. Mgr.

Assembly Engineering
Industrial Finishing
Infosystems
Machine and Tool Blue Book
Manufacturing Systems
Office Products Dealer
Quality

ACOUSTICAL PUBLICATIONS, INC.
27101 E Oviatt Rd.
(POB-40416,Bay Village,OH 44140)
Bay Village OH 44140
(216)835-0101
Jack K. Mowry-President/Publisher

Sound and Vibration

ALLURED PUBLISHING CORPORATION
214 W. Willow St.
(Box 318,Wheaton,IL 60189)
Wheaton IL 60189-0318
(312)653-2155
Nancy Allured-Vice President

Cosmetics & Toiletries

ANDREWS COMMUNICATIONS INC.
5123 West Chester Pike
(POB-556,Edgemont,PA 19028-0208)
Edgemont PA 19028-0208
(215)353-2565
Richard H. Groves-President/Publisher

CLEWORTH PUBLISHING COMPANY
(Div. of Andrews Communications Inc.)

Electrical Systems Design
Transmission & Distribution

A/S/M COMMUNICATIONS, INC.
49 East 21st Street
New York NY 10010
(212)529-5500
Kenneth Fadner-Exec. Vice President
John C. Thomas, Jr.-President
W. Pendleton Tudor-Chairman

ADWEEK/East
ADWEEK/National Marketing Edition

435 N. Michigan Ave.
Chicago IL 60611
(312)467-6500

ADWEEK/Midwest

75 Third St., NW
Atlanta GA 30365
(404)881-6442

ADWEEK/Southeast

2909 Cole Ave.
Dallas TX 75204
(214)747-2385

ADWEEK/Southwest

5757 Wilshire Blvd.,Suite M110
Los Angeles CA 90036
(213)937-4330

ADWEEK/West

ASHLEE PUBLISHING COMPANY, INC.
310 Madison Ave.
New York NY 10017
(212)682-7681
Oscar S. Glasberg-Vice President/Publisher

Glass Digest
Glass Industry

ASSOCIATED BUSINESS PUBLICATIONS, INC.
41 East 42nd St.
New York NY 10017-5203
(212)490-3999
Bill Schnirring-President/Publisher

NASA Tech Briefs

BARKS PUBLICATIONS, INC.
400 N. Michigan Ave.
Chicago IL 60611-4198
(312)321-9440
Horace B. Barks-President/Publisher

Electrical Apparatus

BETTER ROADS MAGAZINE
6300 River Road
(Box-558,Park Ridge,IL 60068)
Rosemont IL 60018
(312)693-7710
William O. Dannhausen-Owner/Publisher

Better Roads

BEVERAGE MEDIA, LTD.
161 Avenue of the Americas
New York NY 10013
(212)620-0100
William G. Slone-President

Beverage Media

BILL COMMUNICATIONS, INC.
633 Third Ave.
New York NY 10017
(212)986-4800
Morgan T. Browne-President

Incentive Marketing/Incentive Travel
Institutional Distribution
Jobber Retailer
Modern Tire Dealer
Plastics Technology
Restaurant Business
Restaurant and Hotel Design
Sales & Marketing Management
Successful Meetings

BILLBOARD PUBLICATIONS, INC.
1515 Broadway
New York NY 10036
(212)764-7300
Gerald S. Hobbs-President

Amusement Business
Billboard
Interiors
Photo Business

BOBBIN INTERNATIONAL, INC.
1110 Shop Road
(POB-1986,Columbia,SC 29202)
Columbia SC 29202
(803)771-7500
Ronald L. Segal-Chairman

Bobbin

BOBIT PUBLISHING CO.
2512 Artesia Blvd.
Redondo Beach CA 90278-3296
(213)376-8788
Edward J. Bobit-Chairman/CEO
Ty Bobit-President

Automotive Fleet
Contemporary Orthopaedics
Contemporary Surgery
Metro
School Bus Fleet

BROADBAND INFORMATION SERVICES, INC.
295 Madison Ave.
New York NY 10017
(212)685-5320
Charles C. Lenz, Jr.-President

BM/E-Broadcast Management/Engineering
*BM/E's World Broadcast News
E&ITV/Educational & Indl Television

BROADCASTING PUBLICATIONS, INC.
1705 DeSales St. NW
Washington DC 20036
(202)659-2340
Lawrence B. Taishoff-President/Publisher

Broadcasting

BUS FAC PUBLISHING CO., INC.
121 Monmouth St.
(POB-2060,Red Bank,NJ 07701)
Red Bank NJ 07701
(201)842-7433
Edgar T. Coene-President/Publisher

Business Facilities

BUSINESS RESEARCH PUBLICATIONS, INC.
817 Broadway
New York NY 10003
(212)673-4700
John G. Roche-Chairman

MacRae's Blue Book

CAHNERS PUBLISHING COMPANY
(division of Reed Holdings, Inc.)
275 Washington St.
Newton MA 02158-1630
(617)964-3030
Saul Goldweitz-Chairman
Ronald G. Segel-President
William M. Platt-President/Mag. Div.

CPI Purchasing
Design News
EDN
Electronic Business
Mini-Micro Systems
Modern Materials Handling
Plastics World
Purchasing Magazine
Test & Measurement World
Traffic Management

1350 E. Touhy Ave.
(POB-5080,Des Plaines,IL 60018)
Des Plaines IL 60018
(312)635-8800

Building Design & Construction
Building Supply Home Centers
Construction Equipment
Consulting/Specifying Engineer
Electronic Packaging and Production
Foodservice Equip./Supplies Specialist
Packaging
Professional Builder
Restaurants & Institutions
Security
Security Distributing & Marketing
Semiconductor International

1301 South Grove
Barrington IL 60010
(312)381-1840

Contractor Magazine
Control Engineering
Highway & Heavy Construction
Plant Engineering
Research & Development

205 East 42nd St.
New York NY 10017
(212)916-1600
(cont'd)

Library Journal
Publishers Weekly
School Library Journal

875 Third Avenue
New York NY 10022
(212)605-9400

American Journal of Cardiology
American Journal of Medicine
American Journal of Surgery
Cutis
Datamation
Graphic Arts Monthly
Industrial Distribution

475 Park Ave. So.
New York NY 10016-6999
(212)686-0555

Corporate Design
Emergency Medicine
Interior Design
Physicians' Travel & Meeting Guide
VA Practitioner

CENTURY COMMUNICATIONS INC.
5520 Touhy Ave.
Skokie IL 60077
(312)676-4060
Philip C. Miller-President/Publisher

Agri Finance
Agri Marketing
Contractors Guide

CHAPIN PUBLISHING COMPANY
7216 Boone Ave. No.
Brooklyn Park MN 55428
(612)537-7730
L. Robert King-Executive Vice President

Construction Bulletin

COAST PUBLISHING, INC.
3255 South U.S. #1
Fort Pierce FL 33450
(305)465-9450
Robert Schweiger-President/Publisher

Quick Printing

COMPASS PUBLICATIONS, INC.
1117 N. 19th St.
Arlington VA 22209-1790
(703)524-3136
Charles H. Bussmann-President/Publisher

Sea Technology

CONCRETE CONSTRUCTION PUBLICATIONS, INC.
426 S. Westgate
Addison IL 60101-4546
(312)543-0870
Daniel P. Anderson-President

Concrete Construction

CORCORAN COMMUNICATIONS, INC.
6200 S.O.M. Center Road
Solon OH 44139
(216)349-3060
Thomas J. Corcoran-President/Publisher

Appliance Manufacturer
Brick & Clay Record
Ceramic Industry

CRAIN COMMUNICATIONS, INC.
740 N. Rush St.
Chicago IL 60611-2590
(312)649-5200
Rance Crain-President

Advertising Age
Business Insurance
Business Marketing
Electronic Media
Modern Healthcare
Pensions & Investment Age

AMERICAN TRADE MAGAZINES, INC.
(Div. of Crain Communications, Inc.)
500 N. Dearborn St.
Chicago IL 60610-9988
(312)337-7700
Edwin Goldstein-President/Publisher

American Drycleaner
American Laundry Digest

CRAIN AUTOMOTIVE GROUP, INC.
(Div. of Crain Communications, Inc.)
1400 Woodbridge Ave.
Detroit MI 48207
(313)446-6000
Keith E. Crain-President

Automotive News

34 No. Hawkins Ave.
Akron OH 44313
(216)836-9180

Rubber & Plastics News

CTE PUBLICATIONS, INC.
464 Central Ave.
Northfield IL 60093
(312)441-7520
John Wm. Roberts-Publisher

Cutting Tool Engineering

CUMMINS PUBLISHING CO., INC.
31600 Telegraph Rd #200
Birmingham MI 48010-3429
(313)645-0300
Andrew J. Cummins-Vice President

Dairy Field
Excavating Contractor
Gourmet Today
Industrial Education

CW COMMUNICATIONS/INC.
(subsidiary of International Data Corp.)
375 Cochituate Road
(POB 9171,Framingham,MA 01701-4668)
Framingham MA 01701-4668
(617)879-0700
W. Walter Boyd-Chairman/IDC Mgt. Com.
Ms. Lee Vidmer-President/Framingham

Computerworld
Infoworld
Micro Marketworld
Network World

DANA CHASE PUBLICATIONS, INC.
1000 Jorie Blvd.
(CS-5030,Oak Brook,IL 60521-2214)
Oak Brook IL 60521-2214
(312)990-3484
Dana Chase, Jr.-President/Publisher

Appliance

DAVIS PUBLICATIONS, INC.
50 Portland St.
Worcester MA 01608-2023
(617)754-7201
Gerald J. Stashak-Vice Pres. & Gen. Mgr.

School Arts Magazine

DECISIONS PUBLICATIONS, INC.
1140 Avenue of the Americas
New York NY 10036
(212)391-2155
Robert C. Gardner-President

Marketing & Media Decisions

DELTA COMMUNICATIONS, INC.
(Div. of Elsevier Business Press, Inc.)
400 No. Michigan Ave.
Chicago IL 60611
(312)222-2000
Wm. J. D'Alexander-President/Publisher

Converting Magazine
Furniture Design & Manufacturing
Modern Metals
Packaging Digest

DEMPA PUBLICATIONS, INC.
400 Madison Ave.
New York NY 10017
(212)752-3003
Yoshi Tsutsui-General Manager

AudioVideo International

DESIGN PUBLICATIONS, INC.
330 West 42nd St.
New York NY 10036
(212)695-4955
Randolph McAusland-President/Publisher

Industrial Design

DIGITAL DESIGN PUBLISHING CORPORATION
1050 Commonwealth Ave.
Boston MA 02215
(617)277-1120
Alan Posner-Business Manager

ESD: The Electronic System Design Mag.

EDITOR & PUBLISHER CO.
11 West 19th St.
New York NY 10011-4234
(212)675-4380
Robert U. Brown-President
Ferdinand C. Teubner-Publisher

Editor & Publisher

ELSEVIER BUSINESS PRESS, INC.
13 Emery Ave.
(Box 1952,Dover,NJ 07801-0952)
Randolph NJ 07869-1380
(201)361-9060
Kenneth H. Nelson-President

(Delta Communications, Inc.)
(Gordon Publications, Inc.)

EW COMMUNICATIONS, INC.
(subsidiary of Argus Press Holdings, Inc.)
1170 East Meadow Drive
Palo Alto CA 94303-4275
(415)494-2800
Anthony J. Yaconetti-President

Defense Electronics
Microwave Systems News/Commun. Technology
Military Logistics Forum

FIELDMARK MEDIA, INC.
(division of Sosland Publishing Co.)
25 West 43rd St.
New York NY 10036
(212)354-5169
Jeffrey A. Schaeffer-President/CEO

Supermarket Business
Totally Housewares

FOLIO PUBLISHING CORP.
Six River Bend
(POB-4949,Stamford,CT 06907-0949)
Stamford CT 06907-0949
(203)358-9900
Joseph J. Hanson-President

Folio:The Magazine for Magazine Mgt.

M.P.E. INC.
(affiliate of Folio Publishing Corp.)

Inside Print

GARDNER PUBLICATIONS, INC.
6600 Clough Pike
Cincinnati OH 45244-4090
(513)231-8020
Richard G. Kline-President

Modern Machine Shop
Production
Products Finishing

GEYER-McALLISTER PUBLICATIONS, INC.
51 Madison Ave.
New York NY 10010-1675
(212)689-4411
Donald McAllister, Sr.-Chairman
Donald McAllister, Jr.-President

Geyer's Office Dealer
Gifts & Decorative Accessories
Playthings
Shipping Digest

GOLF DIGEST/TENNIS, INC.
A New York Times Company
5520 Park Ave.
Trumbull CT 06611-0395
(203)373-7000

Nick Romano-Director/Trade Publications

Golf Shop Operations

GORDON PUBLICATIONS, INC.
(Div. of Elsevier Business Press, Inc.)
13 Emery Ave.
(Box-1952,Dover,NJ 07801-0952)
Randolph NJ 07869-1380
(201)361-9060
Kenneth M. Nelson-President

Biomedical Products
Chemical Equipment
Computer Dealer
Computer Products
Heating,AirConditioning&Plumbing Products
Industrial Product Bulletin
Laboratory Equipment
Mart Magazine
Material Handling Product News
Metalworking Digest

GORMAN PUBLISHING COMPANY
8750 West Bryn Mawr Ave.
Chicago IL 60631
(312)693-3200
William L. Gorman-President/CEO

Bakery Production and Marketing
Dairy Foods
Grocery Marketing
Prepared Foods

GRANT PUBLICATIONS, INC.
155 East 23rd St.
New York NY 10010
(212)505-2600
Gerald J. Giannone-President/Publisher

Automation News

GULF PUBLISHING COMPANY
3301 Allen Parkway
(Box-2608,Houston,TX 77001)
Houston TX 77019
(713)529-4301
William G. Dudley-President/Chairman
Robert M. de Sombre-Senior Vice Presiden

Hydrocarbon Processing
Ocean Industry
Pipe Line Industry
World Oil

HANLEY-WOOD, INC.
655 15th Street, N.W.-Ste 475
Washington DC 20005

(202)737-0717
Michael J. Hanley-Chairman

Builder
Remodeling

HARCOURT BRACE JOVANOVICH, INC.
Harcourt Brace Jovanovich Publications
7500 Old Oak Blvd.
Cleveland OH 44130-3370
(216)243-8100
Robert L. Edgell-Vice Chairman

Aftermarket Business
American Automatic Merchandiser
American Salon
Beverage Industry
Bicycle Dealer Showcase
Body Fashions/Intimate Apparel
Candy Industry
Candy Marketer
Communications News
Concrete
Corporate Meetings & Incentives
Dental Management
Dermatology Times
Drilling, The Wellsite Publication
Drug & Cosmetic Industry
DVM/Newsmagazine of Veterinary Medicine
Exteriors
Flooring
Food & Drug Packaging
Food Management
Geriatrics
Hearing Instruments
Hosiery & Underwear
Hospital Formulary
Hotel & Motel Management
Housewares
Lawn Care Industry
LP-Gas
Meat Processing
Modern Medicine
(cont'd)

Motorcycle DealerNews
Ophthalmology Times
Paper Sales
Paperboard Packaging
Pest Control
Petroleum Engineer International
Pets/Supplies/Marketing
Physician's Management
Pipeline & Gas Journal
Pit & Quarry
Plastics Compounding
Plastics Design Forum
Plastics Machinery & Equipment
Restaurant Management
RSI-Roofing/Siding/Insulation
Snack Food
Telephone Engineer and Management
Urology Times
Video Store
Weeds Trees and Turf

HART PUBLICATIONS, INC.
1900 Grant St.
(POB 1917,Denver,CO 80201-1917)
Denver CO 80203
(303)837-1917
Donald Hart-President/Publisher

Oil and Gas Investor
Western Oil World

HAYDEN/VNU
Hayden Publishing Co.Inc.-Subsid. of VNU
10 Mulholland Dr.
Hasbrouck Heights NJ 07604
(201)393-6000
Robert J. Lydon-President

Computer Decisions
Electronic Design
Microwaves & RF

THE HEARST CORPORATION
Hearst Business Publishing
959 Eighth Ave.
New York NY 10019
(212)262-5700
Gordon Jones-Vice President

60 East 42nd St.
New York NY 10165
(212)682-3710
Domenic A. Mucchetti-Group Vice President

American Druggist
Diversion
Electronic Products
Floor Covering Weekly
Motor
(cont'd)

Office World News
Today's Office

HENDON, INC.
1000 Skokie Blvd.
Wilmette IL 60091-1146
(312)256-8555
H. Scott Kingwill-President/Publisher

Law and Order

HIGH TECH PUBLICATIONS, INC.
23868 Hawthorne Blvd.
Torrance CA 90505-5908
(213)378-0261
Carole Benoit Black-President/Pub.

Fiberoptic Product News
Lasers & Applications

HOWARD RAUSCH ASSOCIATES, INC.
235 Bear Hill Rd.
Waltham MA 02154
(617)890-2700
Howard Rausch-President/Publisher

Lightwave, The Journal of Fiber Optics

INTERNATIONAL THOMSON BUSINESS PRESS
Glen Pointe Centre West
Teaneck NJ 07666
(201)836-8400
Charles P. Daly-President

INTERNATIONAL THOMSON COMMUNICATIONS
600 Grant St.
Denver CO 80203
(303)860-0111
Patrick Keleher-President/CEO

CableVision
Communications Engineering & Design/CED

INTERNATIONAL THOMSON INDUSTRIAL PRESS
6521 Davis Industrial Parkway
Solon OH 44139
(216)248-1125
Manley P. Ludwig-President

Designfax
Fastener Technology International
Metlfax Magazine
PurchasingWorld
Tooling & Production
Wire Tech

INTERNATIONAL THOMSON RETAIL PRESS
345 Park Avenue So.
New York NY 10010
(212)686-7744
(cont'd)

Stuart J. Horton-President/CEO

Audio Times
Autosound & Communications
Computer Reseller Monthly
Consumer Electronics/Computer Electronics
Convenience Store Merchandiser
Food & Beverage Marketing
Modern Floor Coverings
Non-Foods Merchandising
Product Marketing
Toy & Hobby World
Video Business

INTERNATIONAL THOMSON TRANSPORT PRESS
424 W. 33rd St.
New York NY 10001
(212)714-3100
Paul H. Moore-President

Pacific Traffic
Traffic World

MCKNIGHT MEDICAL COMMUNICATIONS, INC.
550 Frontage Rd. #3000
Northfield IL 60093
(312)446-1622
William M. McKnight-President

Hospital Purchasing News
Medical Products Sales
Today's Nursing Home

MED PUBLISHING INC.
666 Plainsboro Rd.-Bldg. #1000
Plainsboro NJ 08536
(609)275-1900
John J. Hennessy-President

Geriatric Medicine Today
IM-Internal Medicine for the Specialist
Practical Cardiology

MEDICAL ECONOMICS COMPANY INC.
680 Kinderkamack Rd.
Oradell NJ 07649
(201)262-3030
Thomas J. McGill-President/CEO

Contemporary Ob/Gyn
Contemporary Pediatrics
Diagnosis
Drug Topics
Medical Economics
Medical Economics for Surgeons
MLO/Medical Laboratory Observer
MLP/Medical Laboratory Products
RN (The Professional Resource for Nurses)

PATIENT CARE COMMUNICATIONS INC.
16 Thorndale Circle
(POB 1245,Darien,CT 06820-9983)
Darien CT 06820-9983
(203)655-8951
Jack E. Angel-President/Publisher

Patient Care

VETERINARY MEDICINE PUBLISHING CO.
9073 Lenexa Drive
Lenexa KS 66215
(913)492-4300
Andy Weber-President/Publisher

Veterinary Economics
Veterinary Medicine

WARD'S COMMUNICATIONS, INC.
28 W. Adams
Detroit MI 48226
(313)962-4433
Roger K. Powers-President

Ward's Auto World

INTERTEC PUBLISHING CORPORATION
(a subsidiary of Macmillan Inc.)
9221 Quivira Rd.
(Box-12901,Overland Park,KS 66212)
Overland Park KS 66215
(913)888-4664
R. J. Hancock-President & Gen. Mgr.

Broadcast Engineering
Cellular Business
Electronic Servicing & Technology
Engineer's Digest
Grounds Maintenance
Lawn & Garden Marketing
Lawn Servicing
Microservice Management
Mobile Radio Technology
S&VC/Sound & Video Contractor
Telecarrier
Telephony
Video Systems

JOHNSON HILL PRESS, INC.
1233 Janesville Ave.
Fort Atkinson WI 53538
(414)563-6388
Jonathan Pellegrin-Chairman

Equipment Today
Farm Equipment
Feed & Grain Times
Furniture/Wood Digest
OEM
(cont'd)

Rental Product News
Yard and Garden

KALO COMMUNICATIONS, INC.
One River Rd.
Cos Cob CT 06807
(203)869-8200
Gilbert W. Chapman, Jr.-President

United States Banker

KELLER INTERNATIONAL PUBLISHING CORP.
150 Great Neck Rd.
Great Neck NY 11021
(516)829-9210
Gerald E. Keller-President

Beverage World

KONA-CAL, INC.
707 Lake Cook Rd.
Deerfield IL 60015-9956
(312)498-3180
James D. Moss-President

Successful Dealer, The

KONA COMMUNICATIONS, INC.
707 Lake Cook Rd.
Deerfield IL 60015-9956
(312)498-3180
James D. Moss-President/Publisher

Heavy Duty Distribution
Renews

LAURIN PUBLISHING CO., INC.
Berkshire Common
(POB-1146,Pittsfield,MA 01202)
Pittsfield MA 01202
(413)499-0514
Francis T. Laurin-President

Photonics Spectra

LEBHAR-FRIEDMAN INC.
425 Park Ave.
New York NY 10022
(212)371-9400
J. Roger Friedman-President

Apparel Merchandising
Chain Store Age Executive
Chain Store Age Gen'l Merch. Trends
Computer + Software News
Discount Store News
Drug Store News
National Home Center News
Nation's Restaurant News

LOCKWOOD TRADE JOURNAL CO., INC.
130 West 42nd St.
New York NY 10036
(212)391-2060
Robert H. Lockwood-President/Publisher

Tobacco International

MACHALEK PUBLISHING COMPANY
15 S. Ninth St.
Minneapolis MN 55402
(612)370-0413
Dick Powell-President/CEO

Pharmaceutical and Cosmetic Equipment
Powder/Bulk Solids

MACLEAN HUNTER MEDIA INC.
1351 Washington Blvd.
Stamford CT 06902
(203)325-3500
John W. Skeels-President

Frozen Food Age
National Mall Monitor
Progressive Grocer

MACLEAN HUNTER PUBLISHING CO.
300 West Adams
Chicago IL 60606-5185
(312)726-2802
M. Dan Sember-President

American Printer
Boxboard Containers
Coal Mining
Concrete Products
Graphic Arts Product News
Paper, Film & Foil Converter
Remodeling Contractor
Rock Products

LAKEWOOD PUBLICATIONS, INC.
(Div. of Maclean Hunter/Chicago)
50 South 9th St.
Minneapolis MN 55402
(612)333-0471
James P. Secord-President

Airport Services Management
Photomethods
Potentials in Marketing
Recreation, Sports & Leisure
Training:The Mag.of Human Resources Devel.

MASS TRANSIT, INC.
1190 National Press Bldg.
Washington DC 20045
(202)662-7171
C. Carroll Carter-Publisher/Editor

Mass Transit

MCGRAW-HILL, INC.
1221 Avenue of the Americas
New York NY 10020
(212)512-2000

MCGRAW-HILL PUBLICATIONS CO.
John G. Wrede-President
Paul F. McPherson-Exec. Vice President

American Machinist & Automated Mfg.
Aviation Week & Space Technology
Chemical Engineering
Chemical Week
Coal Age
Electrical World
Engineering and Mining Journal
Fleet Owner
Graduating Engineer
Industrial Chemical News
Modern Plastics
Power
Textile World
33 Metal Producing

MCGRAW-HILL BOOK CO.
Donald L. Fruehling-President

Drug Therapy
PA Update
Physician & Sportsmedicine, The
Physician's Financial News
Postgraduate Medicine

MCGRAW-HILL INFORMATION SYSTEMS CO.
Richard B. Miller-President

Architectural Record
Data Communications
EC&M/Elec. Construction & Maintenance
Electrical Wholesaling
Electronics
ENR

METALS AND PLASTICS PUBLICATIONS, INC.
One University Plaza
Hackensack NJ 07601-6296
Palmer H. Langdon-President
Eugene B. Nadel-Publisher

Metal Finishing

MILLER FREEMAN PUBLICATIONS, INC.
500 Howard St.
San Francisco CA 94105
(415)397-1881
Marshall W. Freeman-President

Cardio
Circuits Manufacturing
Computer Language
Diagnostic Imaging
Electronics Test
Forest Industries
Pulp & Paper
*PPI/Pulp & Paper International
UNIX Review
*World Wood

MIRAMAR PUBLISHING CO.
2048 Cotner Ave.
Los Angeles CA 90025-9988
(213)477-1033
Tim Novoselski-President/Publisher

Homecare
Homecare Product News
Rental Equipment Register

MURDOCH MAGAZINES
(Div. of News Group Publications, Inc.)
One Park Ave.
New York NY 10016
(212)503-5700
John Evans-President, Murdoch Magazines

Business & Commercial Aviation
Meetings & Conventions
Travel Weekly

MYERS PUBLISHING CO., INC.
60 Ridgeway Plaza
Stamford CT 06905
(203)356-1745
John R. Myers-President/Publisher

Art Business News

NATIONAL INDUSTRIAL PUBLISHING CO.
1000 Killarney Dr.
Pittsburgh PA 15234-2627
(412)885-6550
C. T. McClelland-President/Publisher

Industrial Heating

NATIONAL UNDERWRITER COMPANY, THE
420 East Fourth St.
Cincinnati OH 45202
(513)721-2140
Clarence W. Barnes-Vice President

National Underwriter/Life-Health Ed.
National Underwriter/Property-Casualty

NEWPORT PUBLICATIONS
1800 East Deere Ave.
(POB-W,Newport Beach, CA 92658-8910)
Santa Ana CA 92705
(714)261-1636
Kent Powell-President/Publisher

Heavy Duty Trucking
Heavy Truck Salesman

NICK HOCK ASSOCIATES, INC.
537 Post Rd.
Darien CT 06820
(203)655-3216
Nicholas G. Hock-President/Publisher

Ski Business

NICKERSON & COLLINS CO.
850 Busse Highway
Park Ridge IL 60068
(312)298-6210
J. S. Robinson-President/Publisher

Footwear Manufacturing
Locksmith Ledger

NORTH AMERICAN PUBLISHING CO.
401 N. Broad St.
Philadelphia PA 19108
(215)238-5300
I. J. Borowsky-Chairman
N. S. Borowsky-President

American School & University Magazine
Business Forms & Systems
Dealerscope-Merchandising
In-Plant Reproductions/Electronic Publng.
Printing Impressions
Target Marketing

OMAN PUBLISHING, INC.
90 Throckmorton Ave.
(POB-1059,Mill Valley,CA 94942)
Mill Valley CA 94942
(415)388-7575
Michael J. Alaimo-Editor & Publisher

Meat & Poultry Magazine

PENNWELL PUBLISHING CO.
1421 So. Sheridan Road
(POB-1260,Tulsa,OK 74101)
Tulsa OK 74112
(918)835-3161
Philip C. Lauinger, Jr.-President

Computer Design
Computer Graphics World
Dental Economics
Electric Light & Power
Fire Engineering
Laser Focus/Mag. of Electro-Optics Tech.
Offshore
Oil & Gas Journal
Oil, Gas & Petrochem Equipment
Power Engineering
Solid State Technology
Telecommunication Products + Technology

PENTON PUBLISHING, INC.
(subsidiary of Pittway Corporation)
1100 Superior Ave.
Cleveland OH 44114
(216)696-7000
Thomas L. Dempsey-Chairman
Sal F. Marino-President

Computer-Aided Engineering
Contracting Business
Foundry Management & Technology
Government Product News
Handling & Shipping Management
Heating/Piping/Air Conditioning
Hydraulics & Pneumatics
Lodging Hospitality
Machine Design
Material Handling Engineering
Materials Engineering
Modern Office Technology
New Equipment Digest
Occupational Hazards
Power Transmission Design
Precision Metal
Production Engineering
Restaurant Hospitality
School and College Product News
Welding Design & Fabrication

826 Broadway
New York NY 10003
(212)477-4700

Millimeter

PENTON PUBLISHING/REINHOLD
600 Summer St.
(POB-1361,Stamford,CT 06904)
Stamford CT 06904
(cont'd)

(203)348-7531
Philip H. Hubbard, Jr.-President

Air Transport World
Progressive Architecture

PETROLEUM MANAGEMENT
7887 San Felipe
Houston TX 77063
(713)789-7887
Eldon R. Ball-Associate Publisher

Petroleum Management

PUBLIC UTILITIES REPORTS, INC.
1700 N. Moore St.
Arlington VA 22209
(703)243-7000
James M. McInnis-President/CEO

Public Utilities Fortnightly

PUTMAN PUBLISHING COMPANY
301 East Erie St.
Chicago IL 60611-3060
(312)644-2020
Grace E. Cappelletti-President

Baking Industry
Chemical Processing
Chemical Product News
Food Processing
Plant Services

RCR PUBLICATIONS INC.
1725 Marion Street
Denver CO 80218
(303)832-6000
Charles W. Cleworth-President

Radio Communications Report

SCHNELL PUBLISHING CO., INC.
100 Church St.
New York NY 10007-2694
(212)732-9820
Arthur R. Kavaler-President/Publisher

Chemical Business
Chemical Marketing Reporter (OPD)

SCRANTON GILLETTE COMMUNICATIONS INC.
380 Northwest Highway
Des Plaines IL 60016
(312)298-6622
E. Scranton Gillette-Chairman of Board
H. S. Gillette-President

Roads and Bridges
Seed World

Water/Engineering & Management
Water & Wastes Digest

SENTRY PUBLISHING COMPANY, INC.
1900 West Park Drive
Westborough MA 01581
(617)366-2031
William A. Gannon-Publisher

Software News

SIMMONS-BOARDMAN PUBLISHING CORP.
345 Hudson St.
New York NY 10014-4590
(212)620-7200
A. J. McGinnis, Sr.-Chairman/Exec.Com.
Ranald D. Sclater-President

Intermodal Age International
*Intl Railway Jnl./Rapid Transit Review
Marine Engineering/Log
Railway Age
Railway Track and Structures

S-N PUBLICATIONS, INC.
600 So. Federal St.
Chicago IL 60605
(312)341-1014
John H. Harling-President/Publisher

Nursing Management

SOSLAND PUBLISHING CO.
(Div. of Sosland Companies, Inc.)
9000 West 67th St.
(POB-29155,Shawnee Mission,KS 66201)
Merriam KS 66202
(913)236-7300
Jeffrey A. Schaeffer-President/CEO

*Agribusiness Worldwide
Baking Equipment
Milling & Baking News

SPRINGHOUSE CORPORATION
1111 Bethlehem Pike
Springhouse PA 19477
(215)646-8700
Edgar M. Buttenheim-Exec. Vice President

Nursing '87
NursingLife

ST PUBLICATIONS
407 Gilbert Ave.
Cincinnati OH 45202
(513)421-2050
Dave R. Swormstedt, Jr.-President

Screen Printing Technology & Management
Signs of the Times
Visual Merchandising & Store Design

STAMATS COMMUNICATIONS, INC.
427 Sixth Ave.,S.E.
(POB-1888,Cedar Rapids,IA 52406)
Cedar Rapids IA 52406
(319)364-6167
Ray J. Walther-Vice President/Publisher

Buildings

STANDARD RATE & DATA SERVICE, INC.
(a subsidiary of Macmillan Inc.)
866 Third Avenue
New York NY 10022
(212)702-2168
Dale R. Bauer-Chairman

3004 Glenview Rd.
Wilmette IL 60091
(312)256-6067
Leonard J. Kudlata-President

Business Publication Rates & Data
Community Publication Rates & Data
Consumer Magazine/Agri-Media Rates & Data
Newspaper Rates & Data
Spot Radio Rates & Data
Spot Television Rates & Data

STEVENS PUBLISHING CORP.
225 North New Road
(POB-7573,Waco,TX 76714)
Waco TX 76710
(817)776-9000
Craig S. Stevens-President/Publisher

Dentist
Modern Dentalab
Occupational Health & Safety
RDH:Natl Mag for Dental Hygiene Professls.

SUTTON PUBLISHING COMPANY, INC.
707 Westchester Ave.
White Plains NY 10604-3179
(914)949-8500
Glenn Sutton, Jr.-Chairman

C E E
E E-Electronic/Electrical Product News
E E's Electronics Distributor

TECHNICAL MARKETING CORPORATION
1460 Post Road East
Westport CT 06880
(203)255-9997
Robert J. Dowling-President/Publisher

High-Tech Marketing

TECHNICAL REPORTING CORP.
1098 So. Milwaukee Ave.
(POB-745,Wheeling,IL 60090)
Wheeling IL 60090
(312)537-6460
Philip W. Palmer-President

Distributor
Service Reporter

THOMAS PUBLISHING COMPANY
One Penn Plaza
New York NY 10119
(212)695-0500
Carl T. Holst-Knudsen-President

Inbound Logistics
Industrial Equipment News
Managing Automation

TRADE PRESS PUBLISHING CO.
2100 West Florist Ave.
(POB-694,Milwaukee,WI 53201)
Milwaukee WI 53209
(414)228-7701
Robert H. Apple-President

Building Operating Management
Sanitary Maintenance

VANCE PUBLISHING CORP.
400 Knightsbridge Pkwy
(POB-400,Prairie View,IL 60069)
Lincolnshire IL 60069
(312)634-2600
William C. Vance-Chairman
John B. O'Neil-Vice Chairman

Business Electronics Dealer
Grower, The
Home Center Magazine
Modern Jeweler
Modern Salon
Packer, The
Pork '87
Wood & Wood Products

WHITNEY COMMUNICATIONS CO.
Publications Division
850 Third Ave.
New York NY 10022
(212)715-2600
John S. Prescott-President

Boating Industry

ZIFF-DAVIS PUBLISHING COMPANY
One Park Ave.
New York NY 10016
(212)503-3500
Philip Sine-Senior Vice President

Digital Review
Government Computer News
PC Tech Journal
PC Week

INTERNATIONAL AFFILIATE COMPANIES

NORTH AMERICA (United States)

INTERCONTINENTAL PUBLICATIONS, INC.
15 Ketchum St.
(POB-5017,Westport,CT 06880)
Westport CT 06880
(203)226-7463
Paul R. Green-President/Publisher

*Desarrollo Nacional-America Latina
*Labmedica
*National Development
*Worldwide Projects

JOHNSTON INTERNATIONAL PUBLISHING CORP.
386 Park Ave So.
New York NY 10016
(212)689-0120
Hugh M. Hyde-President

*Alam Attijarat (The World of Business)
*Automobile International/Automovil Int'l
*Far East Business
*Industrial World/Ind. World en Espanol

LINEAL PUBLISHING COMPANY
2425 E. Commercial Blvd.
Fort Lauderdale FL 33308-4003
(305)776-7308
Irv Lineal-President/Publisher

*Industria Internacional/Industry Int'l
*Today's Transport International
*Transporte Moderno

NATURE PUBLISHING COMPANY
(subsidiary of Macmillan Journals Ltd.)
65 Bleecker St.
New York NY 10012
(212)477-9600
Gary M. Rekstad-President/CEO

*Nature

RUSPAM COMMUNICATIONS, INC.
2050 Center Ave.
Fort Lee NJ 07024-4981
(201)461-8660
Richard E. Slimermeyer-Publisher

*Sugar y Azucar

NORTH AMERICA (Canada)

CANADIAN ENGINEERING PUBLICATIONS LTD.
111 Peter St.
Toronto,Ont M5V 2W2 Canada
(416)596-1624
Charles F. Broad-President

*Engineering Digest
*New Equipment News
*Retail Merchandising

CLIFFORD/ELLIOT & ASSOCIATES LTD.
Royal Life Bldg,277 Lakeshore Rd. E.
Oakville,Ont L6J 6J3 Canada
(416)842-2884
George F. W. Clifford-President

*Industrial Management
*Plant Engineering and Maintenance
*Purchasing Management Digest

KERRWIL PUBLICATIONS LTD.
501 Oakdale Rd.
Downsview,Ont M3N 1W7 Canada
(416)746-7360
J. W. Kerr-President

*CAD/CAM & Robotics
*Electrical Business
*Le Monde de l'Electricite
*Plastics Business

KOSTUCH COMMUNICATIONS LTD.
980 Yonge St.
Toronto,Ont M4W 2J8 Canada
(416)923-8888
Mitch J. Kostuch-President

*Foodservice & Hospitality

MACLEAN HUNTER LIMITED
Business Publications Division
Maclean Hunter Bldg., 777 Bay St.
Toronto,Ont M5W 1A7 Canada
(416)596-5000
Charles E. Wilson-Vice President

*Aerospace Canada International
*Batiment
*Benefits Canada
*Bureau, Le
*Canadian Advertising Rates & Data
*Canadian Automotive Trade
*Canadian Aviation
*Canadian Building
*Canadian Datasystems
*Canadian Electronics Engineering
*Canadian Grocer
*Canadian Hotel & Restaurant
*Canadian Interiors
(cont'd)

*Canadian Jeweller
*Canadian Machinery & Metalworking
*Canadian Packaging
*Canadian Premiums & Incentives
*Canadian Printer & Publisher
*Canadian Research
*Canadian Travel Courier
*Civic Public Works
*Design Engineering
*Driver-Owner
*Drug Merchandising
*Electronics Product News
*Floor Covering News
*Food in Canada
*Hardware Merchandising
*Heavy Construction News
*Home Goods Retailing
*Hospital Products & Technology
*Indl. Maint. Repair & Overhaul News
*Industrial Product Ideas
*L'Actualite Medicale
*L'epicier
*L'Hospitalite
*Logging & Sawmilling Journal
*Marketing
*Materials Management & Distribution
*Medical Post, The
*Meetings & Incentive Travel
*Modern Purchasing
*Office Equipment & Methods
*Oilweek
*Ontario Medicine
*Pharmacien, Le
*Physician's Management Manuals
*Plant Management & Engineering
*Pulp & Paper Journal
*Quebec Industriel, Le
*Quincaillerie-Materiaux
*Truck Fleet
*Visual Communications Canada

PAGE PUBLISHING CO. LTD.
501 Oakdale Road
Downsview,Ont M3N 1W7 Canada
(416)746-7360
John Kerr-Vice President/Gen. Mgr.

*ComputerData
*Marketnews
*Men's Wear of Canada
*Sports Business
*Toys & Games

SOUTHAM COMMUNICATIONS LIMITED
1450 Don Mills Rd.
Don Mills,Ont M3B 2X7 Canada
(416)445-6641
Richard A. Gardner-President

*British Columbia Lumberman
*Canadian Architect, The
*Canadian Construction Record
*Canadian Consulting Engineer
*Canadian Controls & Instrumentation
*Canadian Doctor
*Canadian Forest Industries
*Canadian Industrial Equipment News
*Canadian Mining Journal
*Canadian Office Products & Stationery
*Canadian Plastics
*Canadian Transportation & Distribution Mgt
*Daily Commercial News & Construc. Record
*Electrical Equipment News
*Genie Construction
*Gifts & Tablewares
*Health Care
*Heating-Plumbing-Air Conditioning
*Journal of Commerce
*Laboratory Product News
*Modern Medicine of Canada/Medecine Moderne
*Operations Forestieres et de Scierie
*Oral Health
*Plomberie-Chauffage et Climatisation
*Pulp and Paper Canada
*Process Industries Canada
*Water and Pollution Control

WADHAM PUBLICATIONS
(A division of Southam Communications)
1450 Don Mills Rd.
Don Mills,Ont M3B 2X7 Canada
(416)442-2000

*Bodyshop
*Canadian Underwriter
*Centre
*Jobber News
*L'Automobile
*Motor Truck
*Service Station & Garage Management
*Trucking Canada

SOUTH AMERICA

LUND INTERNATIONAL PUBLICATIONS,INC.
356 Rua Brigadeiro Tobias
Caixa Postal 30493, Sao Paulo 01000
Sao Paulo,01032 SP Brazil
(11)228-8248
R. Christopher Lund-President

*Construcao Hoje(Construction Today)

AUSTRALIA

RANK PUBLISHING CO. PTY LTD.
9/106 Pacific Highway
St. Leonards NSW 2065 Australia
(02)438-2300
Sandra Yeomans-Director

*Convention, The
*Open House

EUROPE

DANISH TECHNICAL PRESS
4 Skelbaekgade,
DK 1717 Copenhagen V Denmark
(01)21-6801
Peter Muller-President

*Aktuel Elektronik (Electronics-News Brief)
*Byggeindustrien (Building Industry)
*Byggeri (Building)
*Effektivt Landbrug (Larger-Scale Farming)
*Elteknik (Electronic Techniques)
*SMEA(Smith-Machine-Elec.& Auto.Workshops)
*Transport (Transportation and Materials)
*VVS (Heating, Ventilation & Sanitation)

FINDLAY PUBLICATIONS LTD.
Franks Hall
Horton Kirby,Kent,DA49LL U.K.
(0322)77755
R. J. Findlay-Managing Director

*Modern Medicine
*Modern Medicine of Ireland
*Works Management

TECHPRESS PUBLISHING CO. LTD.
Northside House-69 Tweedy Road
Bromley, Kent,BR1 3WA U.K.
(01)290-6666
Brian A. Beecher-Managing Director

*Computer Systems
*Electronics Manufacture & Test
*Electronic Product Design
*Food Processing

ASSOCIATE MEMBER COMPANIES

BROWN PRINTING COMPANY
(printer of magazines & catalogs)
U.S. Highway 14 West
Waseca MN 56093
(507)835-2410
James K. Rifenbergh-President

3M MEDIA SERVICES, INC.
(computer services)
4 High Ridge Park
Stamford CT 06905
(203)329-1170
Richard J. Bradfield-Publishing Sales Mgr.

W. A. KRUEGER COMPANY
(printer/binder of mags./catalogs/books)
7301 East Helm Drive
Scottsdale AZ 85260
(602)948-5650
Jerome M. Cotter-Senior Vice Pres.Sls/Mktg

LIFETIME MEMBERS

Arthur L. Rice, Jr.
26531 Cuba Road
Barrington IL 60010
(312)381-5135

Hershel Sarbin
525 Park Ave., 3A
New York NY 10021
(212)751-8907

ABP Member Publications Listed by Fields Served

1 . Advertising & Marketing
Advertising Age(p.6)
Agri Marketing(p.5)
ADWEEK/East(p.3)
ADWEEK/Midwest(p.3)
ADWEEK/National Marketing Edition(p.3)
ADWEEK/Southeast(p.3)
ADWEEK/Southwest(p.3)
ADWEEK/West(p.3)
Broadcasting(p.4)
Business Marketing(p.6)
Business Publication Rates & Data(p.15)
Community Publication Rates & Data(p.15)
Consumer Mag./Agri-Media Rates & Data(p.15)
Editor & Publisher(p.7)
Food & Beverage Marketing(p.10)
High-Tech Marketing(p.15)
Incentive Marketing/Incentive Travel(p.4)
Inside Print(p.7)
Marketing & Media Decisions(p.7)
Newspaper Rates & Data(p.15)
Potentials in Marketing(p.11)
Signs of the Times(p.15)
Spot Radio Rates & Data(p.15)
Spot Television Rates & Data(p.15)
Target Marketing(p.13)

2 . Air Conditioning, Heating, Plumbing
Contracting Business(p.13)
Contractor Magazine(p.5)
Distributor(p.15)
Heating/Piping/Air Conditioning(p.13)
Heating,AirCond. & Plumbing Products(p.8)
Service Reporter(p.15)

3 . Amusements
Amusement Business(p.4)

3A. Appliances
Appliance(p.6)
Appliance Manufacturer(p.6)
Mart Magazine(p.8)

4 . Architecture
Architectural Record(p.12)
Building Design & Construction(p.5)
Progressive Architecture(p.14)

5A. Automatic Data Systems
Computer + Software News(p.11)
Computer Dealer(p.8)
Computer Decisions(p.9)
Computer Design(p.13)
Computer Graphics World(p.13)
Computer Language(p.12)
Computer Products(p.8)
Computer Reseller Monthly(p.10)
Computer-Aided Engineering(p.13)
Computerworld(p.6)
Data Communications(p.12)
Datamation(p.5)
Digital Review(p.16)
ESD:Electronic System Design Mag.(p.7)
Government Computer News(p.16)
Infosystems(p.3)
Infoworld(p.6)
Micro Marketworld(p.6)
Mini-Micro Systems(p.5)
PC Tech Journal(p.16)
PC Week(p.16)
Software News(p.14)
UNIX Review(p.12)

6 . Automotive
Aftermarket Business(p.8)
Automotive Fleet(p.4)
Automotive Industries(p.3)
Automotive Marketing(p.3)
Automotive News(p.6)
Jobber Retailer(p.4)
Modern Tire Dealer(p.4)
Motor(p.9)
Motor/Age(p.3)

Ward's Auto World(p.10)

7 . Aviation & Aerospace
Air Transport World(p.14)
Airport Services Management(p.11)
Aviation Week & Space Technology(p.12)
Business & Commercial Aviation(p.12)
NASA Tech Briefs(p.4)

9 . Baking
Bakery Production and Marketing(p.8)
Baking Equipment(p.14)
Baking Industry(p.14)
Milling & Baking News(p.14)

10 . Banking
Agri Finance(p.5)*
United States Banker(p.11)

12 . Beauty & Hairdressing
American Salon(p.8)
Modern Salon(p.15)

13 . Biotechnological Sciences
Biomedical Products(p.8)

14 . Boating
Boating Industry(p.16)

15 . Books & Book Trade
Publishers Weekly(p.5)

15A. Bottling
Beverage Industry(p.8)
Beverage World(p.11)

16 . Brewing, Distilling & Beverages
Beverage Media(p.4)

17 . Brick-Tile,Building Materials
Brick & Clay Record(p.6)

19 . Building
Builder(p.8)
Professional Builder(p.5)
Remodeling(p.8)
Remodeling Contractor(p.11)

19A. Building Management & Real Estate
Building Operating Management(p.15)
Buildings(p.15)
Corporate Design(p.5)

19B. Building Products Retailing
Building Supply Home Centers(p.5)
Home Center Magazine(p.15)
National Home Center News(p.11)

20 . Business
Business Facilities(p.4)

26 . Ceramics
Ceramic Industry(p.6)

27 . Chain Stores
Chain Store Age Executive(p.11)
Chain Store Age Gen'l Merch. Trends(p.11)

28 . Chemical
Chemical Business(p.14)
Chemical Engineering(p.12)
Chemical Equipment(p.8)
Chemical Marketing Reporter (OPD)(p.14)
Chemical Processing(p.14)
Chemical Product News(p.14)
Chemical Week(p.12)
CPI Purchasing(p.5)
Industrial Chemical News(p.12)
Powder/Bulk Solids(p.11)

32 . Clothing (Women's)
Bobbin(p.4)

32B. Coin-Operated & Vending Machines
American Automatic Merchandiser(p.8)

33 . Confectionery
Candy Industry(p.8)
Candy Marketer(p.8)

34 . Control & Instrumentation Systems
Control Engineering(p.5)
I&CS/Indl. & Process Control Mag.(p.3)
IAN/Instrumentation & Control News(p.3)

34A. Corsets, Brassieres, Undergarments
Body Fashions/Intimate Apparel(p.8)

34B. Cosmetics
Cosmetics & Toiletries(p.3)
Product Marketing(p.10)

34C. Dairy Products
Dairy Field(p.6)
Dairy Foods(p.8)

35 . Dental
Dental Economics(p.13)
Dental Management(p.8)
Dentist(p.15)
Modern Dentalab(p.15)
RDH:Natl Mag/Dental Hygiene Profsnls.(p.15)

35A. Department & Specialty Stores
Apparel Merchandising(p.11)
Hosiery & Underwear(p.8)

35B. Department & Specialty Stores
Discount Store News(p.11)

36 . Drugs, Pharmaceutics
American Druggist(p.9)
Drug & Cosmetic Industry(p.8)
Drug Store News(p.11)
Drug Topics(p.10)
Pharmaceutical and Cosmetic Equipment(p.11)

38 . Educational
Industrial Education(p.6)
Library Journal(p.5)
School Arts Magazine(p.6)
School Library Journal(p.5)

38A. Educational--Adult Training
Training:Mag. Human Resources Devel.(p.11)

39 . Electrical
C E E(p.15)

Electric Light & Power(p.13)
Electrical Apparatus(p.4)
Electrical Systems Design(p.3)
Electrical Wholesaling(p.12)
Electrical World(p.12)
EC&M/Elec. Construction & Maintenance(p.12)
Public Utilities Fortnightly(p.14)
Transmission & Distribution(p.3)

40 . Electronic Engineering
Circuits Manufacturing(p.12)
Defense Electronics(p.7)
(cont'd)

E E-Electronic/Electrical Product News
E E's Electronics Distributor(p.15)
Electronic Business(p.5)
Electronic Component News(p.3)
Electronic Design(p.9)
Electronic Packaging and Production(p.5)
Electronic Products(p.9)
Electronics(p.12)
Electronics Test(p.12)
EDN(p.5)
Fiberoptic Product News(p.9)
Laser Focus/Electro-Optics Tech.(p.13)
Lasers & Applications(p.9)
Microservice Management(p.10)
Microwave Systems News/Commun Tech(p.7)
Microwaves & RF(p.9)
Photonics Spectra(p.11)
Semiconductor International(p.5)
Solid State Technology(p.13)
Test & Measurement World(p.5)

40A. Electronic Engineering
Graduating Engineer(p.12)

41 . Engineering & Construction
Concrete(p.8)
Concrete Construction(p.6)
Concrete Products(p.11)
Construction Bulletin(p.5)
Construction Equipment(p.5)
Consulting/Specifying Engineer(p.5)
Equipment Today(p.10)
Excavating Contractor(p.6)
ENR(p.12)
Highway & Heavy Construction(p.5)

44 . Farm Implements
Farm Equipment(p.10)
OEM(p.10)

44C. Feed , Grain & Milling
Feed & Grain Times(p.10)

46 . Financial
Pensions & Investment Age(p.6)

47 . Fire Protection
Fire Engineering(p.13)

48A. Floor Coverings
Floor Covering Weekly(p.9)
Flooring(p.8)
Modern Floor Coverings(p.10)

49A. Fluid Power Systems
Hydraulics & Pneumatics(p.13)

50 . Food--Processing & Distribution
Food Engineering/No. American Edition(p.3)
Food Processing(p.14)
Frozen Food Age(p.11)
Prepared Foods(p.8)
Snack Food(p.9)

54 . Furniture & Upholstery
Furniture Design & Manufacturing(p.7)
Furniture/Wood Digest(p.10)
Wood & Wood Products(p.15)

55 . Gas
LP-Gas(p.8)

57 . Giftware
Art Business News(p.12)
Gifts & Decorative Accessories(p.8)

57A. Glass
Glass Digest(p.4)
Glass Industry(p.4)

59 . Golf
Golf Shop Operations(p.8)

60 . Government & Public Works
Better Roads(p.4)
Government Product News(p.13)
Roads and Bridges(p.14)

61 . Grocery
Convenience Store Merchandiser(p.10)
Gourmet Today(p.6)
Grocery Marketing(p.8)
Non-Foods Merchandising(p.10)
Progressive Grocer(p.11)
Supermarket Business(p.7)

62 . Hardware
Hardware Age(p.3)

63 . Healthcare
Homecare(p.12)
Homecare Product News(p.12)
Medical Products Sales(p.10)
Today's Nursing Home(p.10)

65 . Hospital Administration
Hospital Purchasing News(p.10)
Modern Healthcare(p.6)

66 . Hotels, Motels, Clubs & Resorts
Hotel & Motel Management(p.8)
Lodging Hospitality(p.13)

67 . Housewares
Housewares(p.8)
Totally Housewares(p.7)

69 . Industrial
Quality(p.3)

69A. Industrial Automation
Automation News(p.8)
Managing Automation(p.15)
Manufacturing Systems(p.3)

69B. Industrial Design
Industrial Design(p.7)

70 . Industrial Distribution
Industrial Distribution(p.5)

70A. Industrial Purchasing
Purchasing Magazine(p.5)
PurchasingWorld(p.9)

70B. Industrial Purchasing Directories
MacRae's Blue Book(p.5)

72 . Insurance
Business Insurance(p.6)
National Underwriter/Life-Health Ed.(p.13)
Natl. Underwriter/Property-Casuality(p.13)

73 . Interior Design
Interior Design(p.5)
Interiors(p.4)
Restaurant and Hotel Design(p.4)
Visual Merchandising & Store Design(p.15)

73B. International Trade
Shipping Digest(p.8)

74 . Jewelry
Jewelers' Circular-Keystone(p.3)
Modern Jeweler(p.15)

75 . Journalism & Publishing
Folio:The Magazine for Magazine Mgt.(p.7)

77 . Landscape
Grounds Maintenance(p.10)
Lawn & Garden Marketing(p.10)
Lawn Care Industry(p.8)
Lawn Servicing(p.10)
Weeds Trees and Turf(p.9)
Yard and Garden(p.11)

78 . Laundry & Drycleaning
American Drycleaner(p.6)
American Laundry Digest(p.6)

79 . Leather, Boots & Shoes
Footwear Manufacturing(p.13)

81B. Livestock & Breed
Pork '87(p.15)

82 . Logging & Forest Products
Forest Industries(p.12)

83A. Maintenance
Pest Control(p.9)
Sanitary Maintenance(p.15)

83B. Manufacturing/Industries
Industrial Equipment News(p.15)
Industrial Product Bulletin(p.8)
New Equipment Digest(p.13)

84 . Maritime
Marine Engineering/Log(p.14)

85 . Materials
Materials Engineering(p.13)

85A. Materials Handling
Material Handling Engineering(p.13)
Material Handling Product News(p.8)
Modern Materials Handling(p.5)

86 . Meats & Provisions
Meat & Poultry Magazine(p.13)
Meat Processing(p.8)

87 . Medical & Surgical
American Journal of Cardiology(p.5)
American Journal of Medicine(p.5)
American Journal of Surgery(p.5)
Cardio(p.12)
Contemporary Ob/Gyn(p.10)
Contemporary Orthopaedics(p.4)
Contemporary Pediatrics(p.10)
Contemporary Surgery(p.4)
Cutis(p.5)
Dermatology Times(p.8)
Diagnosis(p.10)
Diagnostic Imaging(p.12)
Diversion(p.9)
Drug Therapy(p.12)
Emergency Medicine(p.5)
Geriatric Medicine Today(p.10)
Geriatrics(p.8)
Hearing Instruments(p.8)
Hospital Formulary(p.8)
IM-Internal Medicine Specialist(p.10)
Medical Economics(p.10)
Medical Economics for Surgeons(p.10)
Modern Medicine(p.8)
MLO/Medical Laboratory Observer(p.10)
MLP/Medical Laboratory Products(p.10)
Ophthalmology Times(p.9)
PA Update(p.12)
Patient Care(p.10)

(cont'd)

Physician & Sportsmedicine, The(p.12)
Physician's Financial News(p.12)
Physician's Management(p.9)
Postgraduate Medicine(p.12)
Practical Cardiology(p.10)
Urology Times(p.9)
VA Practitioner(p.5)

88 . Metal, Metalworking & Machinery
American Machinist & Automated Mfg.(p.12)
Assembly Engineering(p.3)
Cutting Tool Engineering(p.6)
Fastener Technology International(p.9)
Foundry Management & Technology(p.13)
Industrial Heating(p.12)
Iron Age(p.3)
Iron Age/Metals Producer(p.3)
Machine and Tool Blue Book(p.3)
Metal Finishing(p.12)
Metalworking Digest(p.8)
Metlfax Magazine(p.9)
Modern Machine Shop(p.7)
Modern Metals(p.7)
Precision Metal(p.13)
Production(p.7)
Products Finishing(p.7)
Tooling & Production(p.9)
33 Metal Producing(p.12)

90 . Military & Naval
Military Logistics Forum(p.7)

93 . Mining
Coal Age(p.12)
Coal Mining(p.11)
Engineering and Mining Journal(p.12)

96 . Motor Trucks & Accessories
Commercial Carrier Journal(p.3)
Fleet Owner(p.12)
Heavy Duty Distribution(p.11)
Heavy Duty Trucking(p.13)
Heavy Truck Salesman(p.13)
Owner Operator(p.3)
Renews(p.11)
The Successful Dealer(p.11)

97 . Motorcycle & Bicycle
Bicycle Dealer Showcase(p.8)
Motorcycle DealerNews(p.9)

99 . Music & Music Trades
Billboard(p.4)

102 . Nursing & Health
Nursing '87(p.14)
Nursing Management(p.14)
NursingLife(p.14)
RN(p.10)

102B. Ocean Science & Engineering
Sea Technology(p.6)

103 . Office Equipment
Geyer's Office Dealer(p.8)
Office Products Dealer(p.3)
Office World News(p.9)

103A. Office Methods
Modern Office Technology(p.13)
Today's Office(p.9)

104A. Optical & Optometric
Review of Optometry(p.3)

107 . Packaging (Mfrs.)
Boxboard Containers(p.11)
Converting Magazine(p.7)
Paper, Film & Foil Converter(p.11)
Paperboard Packaging(p.9)

107A. Packaging (Users)
Food & Drug Packaging(p.8)
Packaging(p.5)
Packaging Digest(p.7)

108 . Paint & Wallcoverings
Industrial Finishing(p.3)

108 . Paper
Paper Sales(p.9)
Pulp & Paper(p.12)

110 . Parks--Public
Recreation, Sports & Leisure(p.11)

111 . Petroleum
Drilling, The Wellsite Publication(p.8)
Hydrocarbon Processing(p.8)
Ocean Industry(p.8)

Offshore(p.13)
Oil & Gas Journal(p.13)
Oil and Gas Investor(p.9)
Oil, Gas & Petrochem Equipment(p.13)
Petroleum Engineer International(p.9)
Petroleum Management(p.14)
Pipe Line Industry(p.8)
Pipeline & Gas Journal(p.9)
Western Oil World(p.9)
World Oil(p.8)

112 . Pets
Pets/Supplies/Marketing(p.9)

113 . Photographic
Photo Business(p.4)
Photomethods(p.11)

113A. Physical Distribution
Handling & Shipping Management(p.13)
Traffic Management(p.5)

113B. Plant Engineering & Plant Operations
Engineer's Digest(p.10)
Indl Maintenance & Plant Operation(p.3)
Plant Engineering(p.5)
Plant Services(p.4)

114 . Plastics
Modern Plastics(p.12)
Plastics Compounding(p.9)
Plastics Machinery & Equipment(p.9)
Plastics Technology(p.4)
Plastics World(p.5)

115A. Police, Law Enforcement
Law and Order(p.9)

117 . Power & Power Plants
Power(p.12)
Power Engineering(p.13)

117A. Power Transmission
Power Transmission Design(p.13)

118 . Printing & Printing Processes
American Printer(p.11)
Business Forms & Systems(p.13)
Graphic Arts Monthly(p.5)
Graphic Arts Product News(p.11)
In-Plant Reproductions(p.13)
Printing Impressions(p.13)
Quick Printing(p.5)
Screen Printing Technology & Mgt.(p.15)

119 . Produce
Grower, The(p.15)
Packer, The(p.15)

120 . Product Design Engineering
Design News(p.5)
Designfax(p.9)
Machine Design(p.13)
Plastics Design Forum(p.9)
Product Design & Development(p.3)
Sound and Vibration(p.3)

120A. Production Engineering
Production Engineering(p.13)

121 . Public Transportation
Mass Transit(p.12)
Metro(p.4)
School Bus Fleet(p.4)

122 . Radio & Television
Audio Times(p.10)
AudioVideo International(p.7)
Autosound & Communications(p.10)
Broadcast Engineering(p.10)
BM/E-Broadcast Management/Engineering(p.4)
CableVision(p.9)
Communications Eng. & Design/CED(p.9)
Consumer Electronics(p.8)
Dealerscope-Merchandising(p.13)
(cont'd)

E&ITV/Educational & Indl Television(p.4)
Electronic Media(p.6)
Electronic Servicing & Technology(p.10)
Millimeter(p.13)
Mobile Radio Technology(p.10)
Radio Communications Report(p.14)
S&VC/Sound & Video Contractor(p.10)
Video Business(p.10)
Video Store(p.9)
Video Systems(p.10)

124 . Railroad
Railway Age(p.14)
Railway Track and Structures(p.14)

126A. Rental & Leasing Equipment
Rental Equipment Register(p.12)
Rental Product News(P.11)

127 . Restaurants & Food Service
Food Management(p.8)
Foodservice Equip./Supplies Specialist(p.5)
Institutional Distribution(p.4)
Nation's Restaurant News(p.11)
Restaurant Business(p.4)
Restaurant Hospitality(p.13)
Restaurant Management(p.9)
Restaurants & Institutions(p.5)

129 . Roofing
Contractors Guide(p.5)
Exteriors(p.8)
RSI-Roofing/Siding/Insulation(p.9)

130 . Rubber
Rubber & Plastics News(p.6)

131 . Safety
Industrial Safety & Hygiene News(p.3)
Occupational Hazards(p.13)
Occupational Health & Safety(p.15)

131A. Sales Management
Sales & Marketing Management(p.4)

132 . School Administration
American School & University Magazine(p.13)
School and College Product News(p.13)

132A. Science, Research & Development
Laboratory Equipment(p.8)
Research & Development(p.5)

132B. Security
Locksmith Ledger(p.13)
Security(p.5)

Security Distributing & Marketing(p.5)

133 . Seed & Nursery Trade
Seed World(p.14)

135 . Shopping Centers
National Mall Monitor(p.11)

137 . Sporting Goods
Ski Business(p.13)

139 . Stone Products, Etc.
Pit & Quarry(p.9)
Rock Products(p.11)

142 . Telecommunications Technology
Cellular Business(p.10)
Communications News(p.8)
Lightwave, Journal of Fiber Optics(p.9)
Network World(p.6)
Telecarrier(p.10)
Telecommunication Products + Tech.(p.13)
Telephone Engineer and Management(p.9)
Telephony(p.10)

143 . Textiles & Knit Goods
Textile World(p.12)

145 . Tobacco
Tobacco International(p.11)

147 . Toys, Hobbies & Novelties
Playthings(p.8)
Toy & Hobby World(p.10)

148 . Transportation-Traffic
Distribution(p.3)
Inbound Logistics(p.15)
Intermodal Age International(p.14)
Pacific Traffic(p.10)
Traffic World(p.10)

149A. Travel-Conventions & Meetings
Corporate Meetings & Incentives(p.8)
Meetings & Conventions(p.12)
Physicians' Travel & Meeting Guide(p.5)
Successful Meetings(p.4)

149B. Travel-Retail
Travel Weekly(p.12)

152 . Veterinary
DVM/Newsmag. of Veterinary Medicine(p.8)
Veterinary Economics(p.10)
Veterinary Medicine(p.10)

155 . Water Supply & Sewage Disposal
Water & Wastes Digest(p.14)
Water/Engineering & Management(p.14)

156 . Welding
Welding Design & Fabrication(p.13)

158 . Wire & Wire Products
Wire Tech(p.9)

International affiliate Publications
Listed by Fields Served

Advertising, Marketing, Sales
Canadian Advertising Rates & Data(p.17)
Canadian Premiums & Incentives(p.18)
Marketing(p.18)
Visual Communications Canada(p.18)

Architecture
Canadian Architect, The(p.18)

Automotive & Accessories
Automobile International/Automovil Int'l
Bodyshop(p.18)
Canadian Automotive Trade(p.17)
Jobber News(p.18)
L'Automobile(p.18)
Service Station & Garage Management(p.18)

Aviation
Aerospace Canada International(p.17)
Canadian Aviation(p.17)

Building
Batiment(p.17)
Byggeindustrien (Building Industry)(p.19)
Byggeri (Building)(p.19)
Canadian Building(p.17)

Business
Alam Attijarat (World of Business)(p.17)
Benefits Canada(p.17)
Far East Business(p.17)

Chemical
Process Industries Canada(p.18)

Clothing & Accessories
Men's Wear of Canada(p.18)

Controls & Instrumentation Systems
Canadian Controls & Instrumentation(p.18)

Conventions & Meetings
Convention, The(p.19)
Meetings & Incentive Travel(p.18)

Data Processing
Canadian Datasystems(p.17)
Computer Systems(p.19)
ComputerData(p.18)

Dentistry
Oral Health(p.18)

Department & Specialty Shops
Retail Merchandising(p.17)

Drugs
Drug Merchandising(p.18)
Pharmacien, Le(p.18)

Electrical Equipment
Electrical Business(p.17)
Electrical Equipment News(p.18)
Le Monde de l'Electricite(p.17)

Electronics
Aktuel Elektronik(p.19)
Canadian Electronics Engineering(p.17)
Electronic Product Design(p.19)
Electronics Manufacture & Test(p.19)
Electronics Product News(p.18)
Elteknik (Electronic Techniques)(p.19)

Engineering
Canadian Consulting Engineer(p.18)
Engineering Digest(p.17)

Engineering Construction
Canadian Construction Record(p.18)
Construcao Hoje(Construction Today)(p.19)
Daily Comm'l News&Construction Record(p18)
Desarrollo Nacional-America Latina(p.17)
Genie Construction(p.18)
Heavy Construction News(p.18)
Journal of Commerce(p.18)
National Development(p.17)
Worldwide Projects(p.17)

Farming-Feeds
Agribusiness Worldwide(p.14)
Effektivt Landbrug (Farming)(p.19)

Floor Coverings
Floor Covering News(p.18)

Food & Food Processing
Food in Canada(p.18)
Food Processing(p.19)

Forest & Lumber Industries
British Columbia Lumberman(p.18)
Canadian Forest Industries(p.18)
Logging & Sawmilling Journal(p.18)
Operations Forestieres et de Scierie(p.18)
World Wood(p.12)

Gifts & Art Goods
Gifts & Tablewares(p.18)

Government
Civic Public Works(p.18)

Grocery Trade
Canadian Grocer(p.17)
L'epicier(p.18)

Hardware Trade
Centre(p.18)
Hardware Merchandising(p.18)
Quincaillerie-Materiaux(p.18)

Heating, Plumbing, Air Conditioning
Heating-Plumbing-Air Conditioning(p.18)
Plomberie-Chauffage et Climatisation(p.18)
VVS (Heating, Ventilation & Sanit.)(p.19)

Hospital/Health Care
Health Care(p.18)
Hospital Products & Technology(p.18)

Hotels & Restaurants
Canadian Hotel & Restaurant(p.17)
Foodservice & Hospitality(p.17)
L'Hospitalite(p.18)
Open House(p.19)

Industrial
Canadian Industrial Equipment News(p.18)
Indl. Maint. Repair & Overhaul News(p.18)
Industria Internacional/Ind. Int'l(p.17)
Industrial Management(p.17)
Industrial Product Ideas(p.18)
Industrial World/Ind. World Espanol(p.17)
New Equipment News(p.17)
Plant Engineering and Maintenance(p.17)
Plant Management & Engineering(p.18)
Quebec Industriel, Le(p.18)
SMEA(p.19)
Works Management(p.19)

Insurance
Canadian Underwriter(p.18)

Interior Design & Decor
Canadian Interiors(p.17)

Jewelry & Giftware
Canadian Jeweller(p.18)

Materials Handling & Distribution
Materials Management & Distribution(p.18)
Transport(p.19)

Medical
Canadian Doctor(p.18)
L'Actualite Medicale(p.18)
Medical Post, The(p.18)
Modern Medicine(p.19)
Modern Medicine of Canada(p.18)
Modern Medicine of Ireland(p.19)
Ontario Medicine(p.18)
Physician's Management Manuals(p.18)

Metalworking
Canadian Machinery & Metalworking(p.18)

Mining
Canadian Mining Journal(p.18)

Motor Trucks & Buses
Driver-Owner(p.18)
Motor Truck(p.18)
Today's Transport International(p.17)
Transporte Moderno(p.17)
Truck Fleet(p.18)
Trucking Canada(p.18)

Office Equipment
Bureau, Le(p.17)
Office Equipment & Methods(p.18)

Packaging
Canadian Packaging(p.18)

Paper
Pulp & Paper Journal(p.18)
Pulp and Paper Canada(p.18)
PPI/Pulp & Paper International(p.12)

Petroleum Oil & Gas
Oilweek(p.18)

Plastics
Canadian Plastics(p.18)
Plastics Business(p.17)

Printing
Canadian Printer & Publisher(p.18)

Product Engineering & Design
CAD/CAM & Robotics(p.17)
Design Engineering(p.18)

Purchasing
Modern Purchasing(p.18)
Purchasing Management Digest(p.17)

Radio/Television/Hi-Fidelity/Appliances
BM/E's World Broadcast News(p.4)
Home Goods Retailing(p.18)
Marketnews(p.18)

Railways
Intl Railway Jnl./Rapid Trans. Rev.(p.14)

Science, Research & Developement
Canadian Research(p.18)
Laboratory Product News(p.18)
Nature(p.17)

Sporting Goods
Sports Business(p.18)

Stationery
Can. Office Products & Stationery(p.18)

Sugar & Sugar Beets
Sugar y Azucar(p.17)

Toys
Toys & Games(p.18)

Transportation, Traffic, Shipping
Can. Transportation & Distrib. Mgt.(p.18)

Travel
Canadian Travel Courier(p.18)

Water & Wastes Treatment
Water and Pollution Control(p.18)

Mr. FLIPPO. Thank you, Mr. Feldman. Mrs. Gallagher.

STATEMENT OF ALICE GALLAGHER REED, ACTING CHAIRPERSON, CALIFORNIA BUSINESS COALITION

Ms. REED. Mr. Chairman, members of the committee, thank you for this opportunity to present evidence from many tax-paying business owners on a subject which has personal significance on my own business.

I am Alice Reed, the owner of a small retail business in the Bay area of San Francisco, and I am here at my own expense.

I was a delegate to the White House Conference in 1986. Representatives from a number of trade and professional organizations felt that their interests could be best served by a joint effort.

This resulted in the formation of the California Business Coalition. I am here today as the chairman of that organization. When you realize that the activities of the not-for-profit corporations in California during 1985 resulted in nontaxable revenue of at least $65 billion, it is easy to understand why California businesses formed the California Business Coalition.

I have submitted my written testimony and I will submit a document with specific examples of tax-exempt abuses. The statement will be brief, as the chairman has requested, and will address specific examples of abuses, the names of the organizations involved, and the revenues affected.

Member organizations of our coalition who supplied evidence for my testimony, included the California Pharmacist Association, the California Veterinarian Medical Association, the California Audio-Visual Association, the California Specialty Publishers Association, the Hearing Aid Association of California, the Coalition of Travel Agents, the California/Monterey Business Owners, and the Pharmacist Planning Service.

Example No. 1. Public schools in the counties of Los Angeles, Yolo, Alameda, and Ventura, which have an excess of audiovisual equipment and repair facilities, have offered and contracted with private schools who have previously contracted with tax-paying businesses for these services.

Since the purpose of the public schools was to reduce inventory and increase the use of their facilities, they, as nonprofit entities, were able to sell these services to the other nonprofit entities.

The net result was loss of business to three particular businesses. But more importantly, the Federal and State-supported schools will not show an excess inventory, and budgeted monies will not be lost.

Example No. 2. The Dominican Hospital, a not-for-profit corporation in Santa Cruz County, is advertising to its member patients, and to any and all outpatients, that the filling of prescriptions can be done at the hospital pharmacy at a significant saving over the usual retail price.

To illustrate this, Dominican Hospital purchases nitroglycerine patches at a cost of 1 cent per patch, or 30 cents per package of 30.

On the other hand, a tax-paying pharmacy purchases this same patch at a cost of $1.15, or $34.50 per package of 30, and they purchase it from the same manufacturer.

The nonprofit hospital sells these patches to the public at $35 for 30 patches, and realizes a profit of $34.70.

If the pharmacist sold this same product at the same price, he would make a profit of 50 taxable cents.

Example No. 3. For years, Sullivan Publications, a for-profit taxpaying business has engaged in the sales of advertising space in publications sponsored by various nonprofit organizations.

Sullivan's company would sell advertising in buyer's guides, membership directories, industrial guides and maps, under contract with the sponsoring organizations, and provide them with the agreed upon copies.

They have encountered a new situation where the not-for-profit corporations, including civic associations, have decided to take advantage of Sullivan's business expertise and take over these services.

Example No. 4. The Santa Barbara Humane Society has exceeded the bounds of providing shelter and treatment for stray and abandoned animals. In this affluent community, a well-endowed humane society has opened a very large and state-of-the-art boarding kennel offering fee-for-services directly to the public.

In Santa Ynez Valley, another very affluent community in California, veterinary personnel from the humane society have expanded their range of services to include nonlife-threatening veterinary services such as removal of foxtails, routine laboratory work, and making house calls to the local ranchers.

These fee-for-services are a for-profit expansion into community veterinary care.

Example No. 5. A nonprofit community music center in San Francisco with an annual budget of a half million dollars receives $50,000 from the local United Way and continues to actively solicit and receive additional funds from both the public and private sector.

In published materials, they proclaim that their purpose is to provide a music lesson for people of all ages and backgrounds. In addition, they state that the only entrance requirement is that the student is interested in learning. In reality, they are charging their students tuition for their services.

In a number of instances, tuition exceeds $20 an hour. Despite their inducements that the only entrance requirement is the student's interest in learning, they make clear that students will be dropped by the office and lessons will not be given if the tuition is not paid.

And finally, Mr. Chairman, some of these abuses are longstanding, but some are brand new. Just a few years ago, a nonprofit corporation was established for the construction and operation of anew aquarium in Monterey.

The operation opened with much public acclaim, but to the consternation of the restaurants which are its neighbors on Cannery Row, the aquarium is advertising to the public that they can and are providing the rental of their facility to the general public, complete with food service, catering for banquets, souvenir and sundries shop, and special convention packages.

As a result of this new, unfair competition, a number of otherwise successful restaurants and businesses have been forced to close their doors.

The remaining businesses have joined together to seek a way to maintain their investments, to continue to attract the large number of clientele they have served for years, and at the same time provide tax dollars for the support of local, State, and Federal Government.

Mr. Chairman, I hope that these specific examples I have given you today, of why the CBC was formed, why it is growing, and why its efforts in this area are going to expand.

I would like to take a minute and respond to the Department of Treasury's statement. In my quick reading of this statement, it appears that the Treasury is recommending that they receive a more detailed explanation from tax-exempt entities who are involved in income-producing activities.

Additionally, the Treasury is suggesting a redefinition of several significant terms. This recommendation is so broad and uncertain, that it does not provide us with any grounds to either support or reject it.

However, it does make it clear that we taxpayers cannot look for any leadership from them. That is why we are looking for leadership from you and from Congress.

New and inventive tax abuses will occur, as was discussed at a meeting of United Way Agency's task force in October of 1986.

As a business owner/panelist, I was appalled that these well-respected, charitable, nonprofit agencies, would meet to discuss making a profit, and how to increase revenues.

The minutes of this meeting will be furnished to the Committee.

I have one final point. An important, unseen aspect of this whole effort, is the fear that many business owners have expressed to me in regard to publicly criticizing nonprofit corporations.

This fear has been expressed to me many times, and it has allowed many abuses by tax-exempt entities to go unreported.

I thank you, Mr. Chairman, for this opportunity to have given you a few examples of the abuses of the tax-exempt status. I have others, if the committee wishes. It is my sincere hope that this committee will take steps to initiate changes in current law to correct these abuses and inequities.

The California Business Coalition would welcome the opportunity to work with you and your staff, in providing evidence and examples, also in drafting and passing any legislation which results from your study. Thank you.

[Testimony continues on p. 1604. The statement and attachments follow:]

Testimony of
ALICE GALLAGHER REED
submitted to

SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS
U.S. House of Representatives

Hearings to Review the Unrelated Income Business Tax
Week of June 22, 1987

Mr. Chairman and Members, thank you for the opportunity to appear before your committee. I am Alice Gallagher Reed. I was a California delegate to the White House Conference on Small Business, I am Chairman of Implementation for the state, I am the owner of a business and I am the acting chairperson of a newly formed organization in California--the California Business Coalition.

As a result of some informal conversations with leaders of industry and professions in the State of California it became apparent to me that there is an increasing level of concern over the rapid growth of what we perceive to be commercial activities by nonprofit entities in direct competition with the private sector. These conversations resulted in a number of us forming the California Business Coalition. In the short period of time that we have been in existence, we have had expressions of interest from over 20 industry and professional groups.

I am here representing this new organization which includes pharmacists, veterinarians, emergency medical transportation, hearing aid dispensers, travel agents, audio-visual providers, specialty publishers and printers, and others.

My purpose in telling you this is to emphasize the fact that the commercial activities being conducted by nonprofit organizations in California are widespread. My husband and I are the owners of several hearing aid offices. Until recently I was only aware of the effect these activities had on my business. I was amazed to learn how many other businessmen and professionals are faced with the same problem. In fact, I have learned that many cases are more severe than my own.

Using data reported by this committee and the Small Business Administration, we estimate that sixty billion dollars of nontaxable income reported to the Internal Revenue Service is reported by California nonprofit corporations. A substantial portion of this income was derived from the sale of goods and services. For the most part, this represents income lost to taxpaying California businesses.

When you realize the impact of this income loss to private entities in California it is easy to understand why our organization was established. What prompted the formation of the California Business Coalition? Let me give you just a few examples of the types of activities which have been reported to me:

- Nonprofit hospitals in California are engaging in large scale direct mail sale of pharmaceuticals to the general public;

- Many nonprofit organizations such as college student body associations as well as religious and fraternity groups are selling international and national group tours in direct competition with retail travel agents;

- Major community service nonprofit organizations have displaced private publishers who formerly solicited advertising in, printed, and distributed business directories in their communities;

- Churches, lodges, and convention bureaus are renting and repairing audiovisual equipment, and renting videotapes and VCR's to the general public, in direct competition with the taxpaying providers of audiovisual services; and

- Nonprofit organizations which receive major grants from United Way agencies and others are engaging in advertising, sales, service, and repairs of hearing aids to the general public at prices which, because of the tax exempt status of these organizations, enable them to provide hearing aids at a price below that of taxpaying hearing aid dispensers.

Mr. Chairman, from my own experience I can tell you that these hearing aids are not being provided to the indigent and needy as claimed but are being offered to the general public in direct competition with me and my business colleagues.

The examples I have given you are an indication of a wide variety of similar situations occurring throughout the state. Let me give you one specific example which characterizes the problems the private sector is encountering in California.

The new, nonprofit aquarium in Monterey is engaging in direct competition with the rest of Cannery Row by advertising and providing the use of its facilities to the general public for private events. The aquarium rents out space and provides full catering services for these functions. This unfair competition has had such an adverse effect on the Cannery Row restaurants that they felt it necessary to form an organization in response to this threat to their businesses.

Mr. Chairman, I am convinced that this problem is not going to go away unless something is done about it. I recently attended a meeting of United Way agencies where the consensus of the participating agencies was that they would be investigating various commercial ventures in an effort to increase their incomes. This means that the private sector in California can expect increased competition from nonprofit entities on a statewide basis.

Most public service nonprofit organizations were established to fulfill a charitable need, and most of us in the private sector support these institutions. However, some of these organizations are now engaged in commercial, competitive activities which go far beyond their original charter.

In recent years, we have also seen the advent of many "nonprofit" organizations which are thinly disguised commercial ventures established primarily to avoid the payment of taxes and to take advantage of exemptions available to them under current federal law.

Mr. Chairman, I am grateful for this opportunity to give you a few examples of the abuses of tax exempt status by some nonprofit corporations in the State of California. It is my sincere hope that this committee will take steps to initiate changes in current laws to correct these abuses and inequities.

The California Business Coalition would welcome the opportunity to work with you and your staff in drafting and passing any legislation which results from your study of what we believe to be a very serious problem which merits your attention.

Thank you.

CALIFORNIA BUSINESS COALITION
PARK EXECUTIVE BUILDING 925 L STREET SUITE 220 SACRAMENTO, CA. 95814
NORTH STATE 800 341-1441 SOUTH STATE 800 732-3532

July 10, 1987

Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1105 Longworth House Office Building
Washington D. C. 20515

RE: Prepared Statement from California Business Coalition Oral Testimony submitted in writing and documentation

Mr. Chairman, members of the committee, thank you for this opportunity to present evidence from many tax-paying business owners on a subject that has personal significance to my own business. I am Alice Gallagher Reed, the owner of a small retail business in the Bay Area of San Francisco, I was a delegate to the White House Conference in 1986 and testified in Washington at my own expense. Representatives from a number of trade and professional associations felt that their interests could be best served by a joint effort. This resulted in the formation of the California Business Coalition. I am the chairman of that organization.

When you realize that the activities of not-for-profit corporations in this state, during 1985, resulted in NON-TAXABLE REVENUE of at least 65 BILLION DOLLARS, it is easy to understand why the California Business Coalition was formed. I have submitted written testimony and this addendum addresses specific examples of abuses, the names of the organizations or entities involved and the revenues affected. Attached to my written testimony are examples, advertisements or abuses and the minutes from the United Way Task Force meeting.
Member organizations who supplied evidence for my testimony included
The California Pharmacist Association
California Veterinary Medical Association
The California Specialty Publishers
The California Hearing Aid Association
Pharmacist Planning Service
The California Audiovisual Association
The Coalition of Travel Agents

EXAMPLE #1

Public schools in the Counties of:
Alameda
Fresno
Los Angeles
Mendocino
Riverside
Sacramento
San Bernadino
San Jose
San Luis Obispo
Santa Ana
Santa Barbara
Santa Clara
Solano
Yolo

Maintain and manufacture excesses of audiovisual films, videos, equipment and repair facilities. These school systems advertise and sell these products and services to the general public and contract with private schools. Since, the public normally purchases audiovisual supplies or services from commercial tax-paying businesses, and these same businesses contract with public or private schools by the bid process, the net result is the LOSS OF REVENUE AND EMPLOYEES to the tax-paying businesses.

The purpose of increasing the public schools audiovisual business was to reduce inventory and increase the use of its' facilities. The state and federally supported school systems would be threatened with the loss of funding , if inventory supplies were to great. Thus, the public schools will not show an excessive inventory and budgeted moneys' will NOT BE LOST.

evidence attached pgs A1 – A27
*note page A15-A16 from "California State Department of Education"

Attachment A1

R D B Electronics, Inc.

August 18, 1986

Riverside County Superintendent of Schools
Mr. J. Frank Moore, President
3939 13th Street
Riverside, California

Dear Mr. Moore,

The Board of Directors of RDB Electronics, Inc., as directed me to inform Riverside County Superintendent of Schools of their unfair business practice, namely the servicing of your audio visual equipment by the University of California/Riverside, a non-profit state agency.

Without notification of dissatisfaction with services performed from 1982-1986, RDB Electronics, Inc. found that Riverside County Schools is sending their audio visual equipment to the University of California/Riverside for servicing.

RDB Electronics, Inc. and its employees pay state, federal and corporate taxes that supports our schools. We also support;

- vehicles
- office space
- business licenses
- insurance
- employee benefits
- technical equipment
- office equipment
- utilities
- employees

To make a profit all of the above has to be overcome. If a school were to compete fairly, it would have to overcome the same overhead costs. Since they do not consider this, we are telling our state and federal government representatives that this situation is unfair competition, and a serious review of the schools business practices is needed.

cont.

897 "B" VIA LATA • COLTON, CALIFORNIA 92324 • (714) 824-0434 • (800) 732-3532 (In Southern California Only)

Attachment A2

page 2

Riverside County
Superintendent of Schools

The private business will shrink and growth opportunities become less as tax exempt and government agencies enter into the profit markets.

Sincerely,

Raymond S. DeBold

Raymond S. De Bold
President

RDB/ld

Attachment A3

R D B Electronics, Inc.

August 18, 1986

University of California, Riverside
Vice Chancellor for Administration
Dr. Rosemary Schraer
900 University Avenue
Riverside, California

Dear Dr. Schraer,

The Board of Directors of RDB Electronics, Inc. has directed me to inform the University of California, Riverside of their unfair business practices, namely the repair services provided by your audio-visual department for the Riverside County Schools at 3939 13th Street, Riverside, California. It appears that UCR (a non-profit agency) is using their vehicles, test equipment, tools and employees to compete against the local private businesses. Because of the way a school obtains its funds to operate, we feet that this competition is totally unfair.

It is our opinion that fair competition can exist when competing parties do so under the same rules and guide lines. This means we buy at the same levels and sell competitively. The competing levels of sales is determined by what our overhead costs are, such as

vehicles
office space
business licenses
insurance
employee benefits
property taxes
test equipment
office equipment
employees
utilities
state sales tax
business or corporate taxes

RDB pays corporate taxes as well as state and payroll taxes. Our employees pay state and federal taxes and all these taxes support our state and federal agencies.

It is the view of RDB Electronics, Inc. that we are competing against the money (taxes) we give to the state and federal governments. This is unfair competion and a review of your business practices is in order. Are you going to be an educational institution or go into business and compete, using our tax dollars against private business.

897 "B" VIA LATA • COLTON, CALIFORNIA 92324 • (714) 824-0434 • (800) 732-3532 (In Southern California Only)

Attachment A4

page 2

University of California

The private business will shrink and growth opportunities become less as tax exempt and government agencies enter into profit markets.

Sincerely,

Raymond S. De Bold

Raymond S. De Bold
President
RDB ELECTRONICS, INC.

RSD/ld

CC:
Steven C. Marks
Riverside County Superintendent of Schools

response to Bill Leonard [illegible]

Attachment A5

Riverside County Office of Education
3939 Thirteenth Street • P.O. Box 868 • Riverside, California 92502 • (714) 788-6530

Don F. Kenny, Superintendent 788-6670
Morris L. Reeves, Asst. Supt., Administration and Business Services 788-6567

September 9, 1986

Mr. Raymond S. De Bold, President
RDB Electronics, Inc.
897 "B" Vialata
Colton, CA 92324

Subject: Audio Visual Equipment Repairs

Dear Mr. De Bold:

Your letter regarding our current practice of having our audio visual equipment serviced by the University of California, Riverside, has been reviewed.

Our staff has assured me that our current practice of using other government agencies to provide services is a prudent business practice. Our staff is not aware of any prohibitions from using other government agencies for this purpose. Education Code 1250 specifically permits us to actually repair our audio visual equipment, as well as that of our Districts, should we desire to do so. We know of another County Office that actually is in the audio visual repair business for their equipment as well as their districts. We, however, do not have plans at this time to repair our equipment. As a matter of fact, on occasion we have referred district personnel to your firm for service.

Our basis for having the University of California, Riverside, service our equipment is that they can repair our complete line of audio visual equipment without referring items such as certain video equipment to others, as you have done on occasion with some of our equipment. We also reduce our costs appreciably and utilize available labor and facilities of the University.

We have been satisfied with your service in the past and may, on occasion, use your services sometime in the future.

Thank you again for your interest in our requirements.

Sincerely,

Don F Kenny

Don F. Kenny
Superintendent

DFK:GLS:jb

County Board of Education

Betty Gibbel, President · Marilyn Baumert · Gerald P. Colapinto · Curtis Grassman · Milo P. Johnson · J. Frank Moore · Ruth Miller, Vice-President

Attachment A6

STATE CAPITOL
SACRAMENTO 95814
(916) 445-7552
DISTRICT OFFICE
1323 WEST COLTON AVENUE
SUITE 101
REDLANDS, CALIFORNIA 92374

(714) 798-4242 REDLANDS
(714) 383-4137 SAN BERNARDINO
800-325-9788 TOLL FREE

California Legislature

BILL LEONARD
STATE ASSEMBLYMAN
SAN BERNARDINO COUNTY

COMMITTEES
  WAYS AND MEANS
  UTILITIES AND COMMERCE
  EDUCATION
  CONSUMER PROTECTION
SUBCOMMITTEES
  WAYS & MEANS
    CHAIRMAN EMPLOYEE COMPENSATION
    EDUCATION
  EDUCATION
    HIGHER EDUCATION
JOINT LEGISLATIVE
  BUDGET COMMITTEE
JOINT COMMITTEE FOR THE REVIEW OF THE
  MASTER PLAN FOR HIGHER EDUCATION
SPECIAL COMMITTEE ON
  MEDI-CAL OVERSIGHT
SELECT COMMITTEE ON CHILD ABUSE

September 10, 1986

Raymond S. De Bold
RDB Electronics, Inc.
897 "B" Vialata
Colton, CA 92324

Dear Mr. De Bold:

Your letter outlining the difficulties that you are having with the University of California, Riverside has reached me. I will correspond with you as soon as I receive answers to the inquiries that I am making on your behalf.

If you have any further questions or comments on this or on any other State matter of concern to you, please feel free to contact me.

Sincerely,

Bill

BILL LEONARD

BL:rhp

Attachment A7

UNIVERSITY OF CALIFORNIA, RIVERSIDE

BERKELEY • DAVIS • IRVINE • LOS ANGELES • RIVERSIDE • SAN DIEGO • SAN FRANCISCO SANTA BARBARA • SANTA CRUZ

OFFICE OF THE CHANCELLOR
RIVERSIDE, CALIFORNIA 92521-0101
(714) 787-5201

October 6, 1986

Bill Leonard
Assemblyman, 66 District
1323 West Colton Avenue
Suite 101
Redlands, CA 92373

RE: Competition from Non-Profit Business Ventures

Dear Bill:

This letter responds to your recent request to me to provide information to you concerning a letter to you from Mr. R. S. De Bold (RDB Electronics) on this topic.

There is no university policy or state law that restricts one governmental agency from providing services to another governmental agency. We have established general principles for the campus as to whether we do our work through staff employees or solicit vendor-provided labor services. The University of California-Riverside provides services with internal staff as a prudent business practice when:

-- The service is unique in nature and not found in the private sector, most typically for sophisticated and unique scientific equipment.

-- The university can provide the service at less cost than can be secured by public bidding.

-- The service requires staff employees who know the respective physical plant systems and must respond to emergency situations any time of day or night and routinely maintain these systems for efficient operation.

-- The service is provided by employees of the university covered by collective bargaining agreement with UCR as the state agency as provided by state law and PERB decisions.

Now, addressing the issue of one governmental agency providing service to another governmental agency, the University of California-Riverside would only provide services to other governmental agencies when the above criteria are met plus:

-- The revenues collected for work performed fully cover the expense to the campus.

RECEIVED OCT 14 1986

Attachment A8

Bill Leonard
October 6, 1986
Page 2

-- The hours spent on work for other governmental agencies does not detract from the campus mission, or when the work would add to the efficiency of the service, i.e., the campus employee must be on staff to handle the unique campus equipment but could handle more work than is available on the campus. The revenues received reduce not only campus costs but reduce the cost of the governmental agency for whom the work is being done. This prudent business practice allows "economies of scale" to reduce costs for both agencies.

All state agencies have the obligation to provide the best possible service for the least possible cost.

In the specific case of competition with RDB Electronics, Inc., the University of California-Riverside has as of September 8 provided services in total as follows:

Moreno Valley School District	$ 101.64
La Sierra Campus/Loma Linda	803.81
Riverside Public Schools	391.20
	$1296.65

The above amount is relatively small. The University of California-Riverside would only provide services outside the campus based on the above criteria. We have no intention of actively competing in the private sector market place. (Indeed, during the past year we have established a new policy of soliciting bids and services from the private sector, rather than doing the work ourselves, when it is cost-advantageous to do so.) If UCR can help keep state costs down and not endanger our mission, we will continue to provide services to other public agencies. UCR will also encourage those agencies to seek private sector vendors when the price would be less or when we could not effectively provide the service.

If you would like additional information, please do not hesitate to contact this office at 787-5201 or the Vice Chancellor for Administration at 787-3793.

Sincerely,

Ted

Theodore L. Hullar
Chancellor

djc
cc: Thomas G. Nycum
Vice Chancellor--Administration

Attachment A9

STATE CAPITOL
SACRAMENTO 95814
(916) 445-7552
DISTRICT OFFICE
1323 WEST COLTON AVENUE
SUITE 101
REDLANDS, CALIFORNIA 92374

(714) 798-4242 REDLANDS
(714) 383-4137 SAN BERNARDINO
800-325-9766 TOLL FREE

California Legislature

BILL LEONARD
STATE ASSEMBLYMAN
SAN BERNARDINO COUNTY

COMMITTEES
WAYS AND MEANS
UTILITIES AND COMMERCE
EDUCATION
CONSUMER PROTECTION
SUBCOMMITTEES
WAYS & MEANS
CHAIRMAN, EMPLOYEE COMPENSATION
EDUCATION
EDUCATION
HIGHER EDUCATION
JOINT LEGISLATIVE
BUDGET COMMITTEE
JOINT COMMITTEE FOR THE REVIEW OF THE
MASTER PLAN FOR HIGHER EDUCATION
SPECIAL COMMITTEE ON
MEDI-CAL OVERSIGHT
SELECT COMMITTEE ON CHILD ABUSE

October 15, 1986

Raymond S. De Bold
RDB Electronics, Inc.
897 "B" Vialata
Colton, CA 92324

Dear Mr. De Bold:

I am enclosing the response of the University of California, Riverside to your inquiry regarding competition from non-profit business ventures.

Please review the University's letter and contact me if you have any further questions or concerns.

Thank you again for writing. Please continue to keep me informed of State matters of concern to you.

Sincerely,

Bill

BILL LEONARD

BL:rhp
enclosure

Attachment A10

R D B Electronics, Inc.

October 21, 1986

Bill Leonard
Assemblyman, 66th District
1323 West Colton Avenue
Suite 101
Redlands, California

Dear Mr. Leonard,

Per your letter of October 15, 1986, I am requesting an appointment to further discuss the problem of unfair competition to small business from federal and state agencies.

The letter from University of California, Riverside, dated October 6, 1986 explains my position when they say "The university can provide the service for less cost than can be secured by public bidding". Where does it say in any educational publication that an educational institution is in any business other than education.

Addressing the statement "The service is unique in nature and not found in the private sector, most typically for sophisticated and unique scientific equipment". RDB Electronics is fully equipped to furnish the services being provided by UCR and have done so in the past.

My labor rate is $42.00/hr. The figure represents employee salaries, vehicles for pick up and delivery, property taxes, income taxes, social security taxes, workers compensation, office space, tools and test equipment, service manuals, water, gas, electric, advertising, liability insurance and on and on.

897 "B" VIA LATA • COLTON, CALIFORNIA 92324 • (714) 824-0434 • (800) 732-3532 (In Southern California Only)

Attachment A11

Bill Leonard
October 21, 1986
page 2

The labor rate of UCR is $15.00/hr, yet they state in their letter that the revenues collected for work performed fully cover the expense to the campus. Since this amount represents a good portion of the technicians hourly pay, who is paying for all the overhead expenses that the business man is paying. The taxpayer.

If educational institutions are going to go into business, where does that leave the for-profit business. The services that are covered by purchase orders from Riverside Schools, Moreno Valley USD and La Sierra/Loma Linda University are available in the private sector. I need to discuss with you your support for state action on UNFAIR COMPETITION by state and federal agencies.

Sincerely,

Ray DeBold

Ray De Bold
President

RDB/ld

Never got appt! -

Attachment A12

STATE CAPITOL
SACRAMENTO 95814
(916) 445-7552

DISTRICT OFFICE
1323 WEST COLTON AVENUE
SUITE 101
LANDS, CALIFORNIA 92374

(714) 798-4242 REDLANDS
383-4137 SAN BERNARDINO
800-328-0796 TOLL FREE

California Legislature

BILL LEONARD
STATE ASSEMBLYMAN
SAN BERNARDINO COUNTY

COMMITTEES
WAYS AND MEANS
UTILITIES AND COMMERCE
EDUCATION
CONSUMER PROTECTION
SUBCOMMITTEES
WAYS & MEANS
CHAIRMAN, EMPLOYEE COMPENSATION
EDUCATION
EDUCATION
HIGHER EDUCATION
JOINT LEGISLATIVE
BUDGET COMMITTEE
JOINT COMMITTEE FOR THE REVIEW OF THE
MASTER PLAN FOR HIGHER EDUCATION
SPECIAL COMMITTEE ON
MEDI-CAL OVERSIGHT
SELECT COMMITTEE ON CHILD ABUSE

October 22, 1986

Theodore L. Hullar, Chancellor
University of California, Riverside
Riverside, CA 92521-0101

Dear Mr. Hullar:

I am enclosing Mr. DeBold's response to your October 6th letter regarding competition from Non-Profit Business Ventures.

I agree with Mr. DeBold's position and am requesting that the University of California, Riversie policy be changed.

Your assistance with this matter will be greatly appreciated.

Sincerely,

BILL LEONARD

BL:rhp
enclosure

Attachment A13

RDB
R D B Electronics, Inc.

November 5, 1986

Bill Honig
Superintendent of Public
Instruction and Director of Education
721 Capitol Mall
Sacramento, California

Dear Mr. Honig,

This letter is an appeal for your help in resolving the question "are the schools in California in business or in education? The small business people are being hurt financially by public schools using the services of state and federally supported agencies that are available in the private sector. In particular, I am referring to the repair of audio-visual equipment by the University of California, Riverside for the Riverside County Schools. Due to support from tax dollars, these services can be provided far below that of the private sector, putting private business at an unfair advantage.

I am submitting to you correspondence with the University of California, Riverside, Assemblyman Bill Leonard, Riverside County Schools, and Congressman Jerry Lewis on this problem of unfair business competition from tax supported entities.

I will be in Sacramento on November 18, 1986 and would appreciate the opportunity to present this to you or your representative in person. May I call for an appointment?

Sincerely,

Reply NOV 17-86

Ray DeBold
Ray De Bold
President

RDB/ld
ENC.

897 "B" VIA LATA • COLTON, CALIFORNIA 92324 • (714) 824-0434 • (800) 732-3532 (In Southern California Only)

Attachment A14

RDB R D B Electronics, Inc.

November 5, 1986

Congressman Jerry Lewis
101 South 6th Street
Redlands, California

Dear Mr. Lewis,

I am writting this letter to appeal for your help.

Agencies receiving state and federal funds for their support, namely the University of California, Riverside, are now performing the same service available in private sectors, "Audio Visual Service and Repair". UCR is at present repairing equipment for the Riverside County Schools. We feel this is unfair competition.

I am submitting to you letters written by myself to UCR, and Riverside County Schools, Assemblyman Bill Leonard and Superintendent of Public Instruction, Bill Honig on this problem of unfair competition from entities supported by the state and federal taxes.

I will be calling your office for an appointment to present the information I have acquired.

Sincerely,

Ray DeBold

Ray De Bold

RDB/ld

ENC.
Copy to Mr. Bill Honig

897 "B" VIA LATA • COLTON, CALIFORNIA 92324 • (714) 824-0434 • (800) 732-3532 (In Southern California Only)

Attachment A15

CALIFORNIA STATE DEPARTMENT OF EDUCATION — **Bill Honig**
721 Capitol Mall; P.O. Box 944272 — Superintendent
Sacramento, CA 94244-2720 — of Public Instruction

Re - 11-22-86

November 17, 1986

Ray De Bold, President
RDB Electronics, Inc.
897 "B" Via Lata
Colton, CA 92324

Dear Mr. De Bold:

Superintendent of Public Instruction Bill Honig has asked me to respond to your recent letter regarding the repair of audio visual equipment by the University of California, Riverside for the Riverside County Schools.

Neither Mr. Honig nor I favor government's "competing" with private enterprise as general practice, but when an interagency agreement is the most productive and cost efficient way for a government entity to receive necessary goods or services, we see nothing wrong with that approach. In the situation outlined in your letter, a substantial number of tax dollars are already being spent to maintain a repair station at the University of California (UC), Riverside. It makes good sense for the University to offset some of these fixed costs by providing competitively priced services to other government agencies.

Under state budgetary procedures, a feasibility study must already have determined that it is more efficient to staff and equip a repair station at the UC Riverside than for the University to contract out for such services from a private vendor. Having once made that determination, government can gain further savings if those same tax dollars can also be used to allow other government agencies to receive necessary services cheaper than they can be purchased from the private sector.

In my view, the overall interest of the taxpayers is best served when we in Government spend their hard earned tax dollars in the most effective and cost efficient manner possible, even if it means that in some situations government will be "competing" with private enterprise.

Attachment A16

Ray De Bold
November 17, 1986
Page 2

Also, since public education in California is under funded compared with the national average, we have every reason to make the wisest possible use of our resources. To do otherwise I think would betray our responsibility to children of California.

Sincerely,

William C. Pieper
Deputy Superintendent
for Administration
(916) 445-8950

WCP:cmb

Attachment A17

JERRY LEWIS
35TH DISTRICT, CALIFORNIA

COMMITTEES:
APPROPRIATIONS
SUBCOMMITTEES:
HUD-INDEPENDENT AGENCIES
FOREIGN OPERATIONS
LEGISLATIVE BRANCH
(RANKING MEMBER)
CHAIRMAN
HOUSE REPUBLICAN RESEARCH COMMITTEE

Congress of the United States
House of Representatives
Washington, DC 20515

WASHINGTON OFFICE
ROOM 326
CANNON HOUSE OFFICE BUILDING
202-225-5861

DISTRICT OFFICES
1826 ORANGE TREE LANE
SUITE 104
REDLANDS, CA 92374-2821
714-862-6030
714-793-6601

BARSTOW, CA 92311
619-256-1022

December 24, 1986

Mr. Ray De Bold
RDB Electronics, Inc.
897 "B" Via Lata
Colton, California 92324

Dear Mr. De Bold:

Thank you for contacting me regarding audio visual services. I understand your concern that there may unfair competition in this field.

It is out of Congressional courtesy that Members of Congress refer mail to the proper Representative and since your address is in Colton, I am forwarding your letter and enclosed information to Congressman Brown. I am sure you will be hearing from him soon.

Happy Holidays!

Sincerely,

Jerry Lewis

Jerry Lewis
Member of Congress

JL:mk

Pls return to: A19
Martin Earley
Career Aids, Inc
20417 Nordhoff
Chatsworth, Ca 91311
(818) 341-8200
(Earlier edition of this publication available at address or [illegible])

UNFAIR COMPETITION:

How Government Gives the Edge to Nonprofits in the Communications Business

NAVA 21
A20

Subject Indices of Nonprofit Competitors

A. By Type of Activity

The following organizations *produce and distribute A-V products* (please see index for page numbers):

Agency for Instructional Television
Alameda County Schools
American Association for Vocational Instructional Materials
American College Testing Program
University of Arizona
Association for Continuing Education
Brigham Young University
California Polytechnic State University
Center for Southern Folklore
Clemson University
Close Up Foundation
Clovis Unified School District
Coast Telecourses
Consumers Union
Cornell University
Dallas County Community College District
Dallas Independent School District
Daughters of St. Paul
East Texas State University
Education Development Center, Inc.
Educational Resources Foundation
Great Plains National Instructional Television Library
Harvard University Press
University of Iowa
Maryland Center for Public Broadcasting
Massachusetts Institute of Technology
Miami-Dade Community College
University of Michigan
Michigan State University
University of Mid-America
Mid-America Vocational Curriculum Consortium
Minnesota Educational Computing Consortium
Mississippi Department of Vocational/Technical Education
University of Missouri
Montclair Public School System
Mt. San Jacinto College
National Gallery of Art
National Geographic Society
National Public Radio
Ohio University
Oklahoma Department of Vocational and Technical Education
Pennsylvania Department of Education
PICA Foundation
Research for Better Schools
Robbinsdale Area Schools
State Fair Community College
Suburban Audio Visual Service
University of Tennessee
University of Texas at Austin
Utah State University Foundation
Vocational Research Institute
University of Wisconsin at Madison
Wisconsin Foundation for Vocational, Technical, and Adult Education

The following organizations *produce* A-V products *for others*:

University of Arizona
Brigham Young University
Coast Telecourses
University of Colorado
Education Development Center, Inc.
University of Iowa
University of Michigan
University of Mid-America
Mississippi Department of Vocational/Technical Education
National Association of Counties
WETACOM
WGVC-TV

The following organizations *distribute* A-V products *for others*:

Aerospace Education Foundation
Agency for Instructional Television
Brigham Young University
University of California
Coast Telecourses
University of Colorado
Conduit
Cornell University
East Texas State University
Educational Resources Foundation
Harvard University Press
Maryland Center for Public Broadcasting
Micro-Ideas
University of Mid-America
University of Missouri
National Council of Churches
PBS Video
Saginaw Intermediate School District

The following organizations offer *miscellaneous* services:

University of Colorado: A-V facilities and equipment rental
Essex County College: A-V facilities and equipment rental
Illinois Department of Administrative Services: cooperative purchasing of A-V equipment
Micro-Ideas: A-V training and consulting, cooperative purchasing of A-V equipment
Minnesota Educational Computing Consortium: Cooperative purchasing of A-V equipment, A-V consulting
Ohio State University: A-V training and consulting
Oklahoma Department of Vocational and Technical Education: A-V training and consulting

A. By Type of Activity *(continued)*

Pennsylvania Department of Education: A-V equipment rental and repair, A-V training and consulting
Project Local: A-V training and consulting, cooperative purchasing of A-V equipment
Saginaw Intermediate School District: A-V equipment repair, cooperative purchasing of A-V equipment
Suburban Audio Visual Service: A-V equipment rental and repair, cooperative purchasing of A-V equipment, A-V consulting
University of Wisconsin, Madison: A-V training and consulting

B. By Type of Organization

The following nonprofit competitors are *schools, colleges, or universities*:

Alameda County Schools
University of Arizona
Brigham Young University
University of California
California Polytechnic State University
Clemson University
Clovis Unified School District
Coast Community Colleges
University of Colorado
Cornell University
Dallas County Community College District
Dallas Independent School District
East Texas State University
Essex County College
Harvard University
University of Iowa
Massachusetts Institute of Technology
Miami-Dade Community College
University of Michigan
Michigan State University
Micro-Ideas
University of Mid-America
University of Missouri
Montclair Public School System
Mt. San Jacinto College
Ohio University
Ohio State University
Robbinsdale Area Schools
Saginaw Intermediate School District
State Fair Community College
University of Tennessee
University of Texas at Austin
Utah State University
University of Wisconsin at Madison

The following organizations are *state agencies*:

Illinois Department of Administrative Services
Mississippi Department of Vocational/Technical Education
Oklahoma Department of Vocational and Technical Education
Pennsylvania Department of Education

The following are *nonprofit corporations or associations*:

Aerospace Education Foundation
Agency for Instructional Television
American Association for Vocational Instructional Materials
American College Testing Program
Association for Continuing Education
Center for Southern Folklore
Close Up Foundation
Conduit
Consumers Union
Daughters of St. Paul
Education Development Center, Inc.
Educational Resources Foundation
Great Plains National Instructional Television Library
Maryland Center for Public Broadcasting
Mid-America Vocational Curriculum Consortium
Minnesota Educational Computing Consortium
National Association of Counties
National Council of Churches
National Gallery of Art
National Geographic Society
National Public Radio
PBS Video
PICA Foundation
Project Local
Research for Better Schools
Suburban Audio Visual Service
Vocational Research Institute
WETACOM (taxable business subsidiary of nonprofit parent)
WGVC-TV
Wisconsin Foundation for Vocational, Technical, and Adult Education

A22

C. By Type of Funding

Only those organizations for which funding information was available are listed here. The funding source indicated (local, state, federal) may apply either to the organization as a whole or to specific A-V products or projects. For greater detail, consult the individual entry for that organization (see index for page numbers). In no case should the funding source indicated be interpreted as an organization's *sole* source. Most nonprofits receive contributions from a wide variety of sources, both public and private. In addition, as noted in several entries above, sale of A-V products represents a major funding source for some. For practical purposes, it is impossible to trace an organization's public funding through its budget allocation process to its A-V efforts. Such a connection is clear-cut only when specific A-V products or projects are required by government grants or contracts.

The following organizations receive *local* funding:

Alameda County Schools
Clovis Unified School District
Coast Community Colleges
Dallas County Community College District
Dallas Independent School District
Essex County College
Miami-Dade Community College
Montclair Public Schools
Mt. San Jacinto College
Project Local
Robbinsdale Area Schools
Saginaw Intermediate School District
State Fair Community College
Utah State University Foundation
Vocational Research Institute
WGVC-TV

The following organizations receive *state* funding:

Agency for Instructional Television
American Association for Vocational Instructional Materials
University of Arizona
University of California
Clemson University
University of Colorado
East Texas State University
Educational Resources Foundation
Great Plains National Instructional Television Library
Illinois Department of Administrative Services
University of Iowa
Miami-Dade Community College
University of Michigan
Michigan State University
Micro-Ideas
University of Mid-America
Mid-America Vocational Curriculum Consortium
Minnesota Educational Computing Consortium
Mississippi Department of Vocational/Technical Education
University of Missouri
Ohio University
Ohio State University
Oklahoma Department of Vocational and Technical Education
Pennsylvania Department of Education
PICA Foundation
Suburban Audio Visual Service
University of Tennessee
University of Texas at Austin
Utah State University Foundation
University of Wisconsin at Madison
WGVC-TV

The following organizations receive *federal* funding:

Aerospace Education Foundation
California Polytechnic State University
Center for Southern Folklore
Close Up Foundation
Conduit
Education Development Center, Inc.
Educational Resources Foundation
Maryland Center for Public Broadcasting
Micro-Ideas
University of Mid-America
National Public Radio
Ohio State University
Research for Better Schools
Vocational Research Institute
University of Wisconsin at Madison
WGVC-TV

D. By Geographic Region

Northeast (Maine, New Hampshire, Vermont, Massachusetts, Connecticut, Rhode Island, and New York):
Consumers Union
Cornell University
Daughters of St. Paul
Education Development Center, Inc.
Harvard University Press
Massachusetts Institute of Technology
National Council of Churches
Project Local

Mid-Atlantic (Pennsylvania, New Jersey, Virginia, West Virginia, Delaware, Maryland, and Washington, D.C.):
Aerospace Education Foundation
Close Up Foundation
Essex County College
Maryland Center for Public Broadcasting
Montclair Public School System
National Association of Counties
National Gallery of Art
National Geographic Society
National Public Radio
PBS Video
Pennsylvania Department of Education
Research for Better Schools
Vocational Research Institute
WETACOM

Southeast (Kentucky, Tennessee, North Carolina, South Carolina, Georgia, Alabama, Mississippi, and Florida):
American Association for Vocational Instructional Materials
Center for Southern Folklore
Clemson University
Educational Resources Foundation
Miami-Dade Community College
Mississippi Department of Vocational/Technical Education
PICA Foundation
University of Tennessee

East Central (Wisconsin, Michigan, Illinois, Indiana, Ohio):
Agency for Instructional Television
Illinois Department of Administrative Services
University of Michigan
Michigan State University

East Central (continued)
Micro-Ideas
Ohio University
Ohio State University
Saginaw Intermediate School District
Suburban Audio Visual Service
University of Wisconsin at Madison
Wisconsin Foundation for Vocational, Technical, and Adult Education
WGVC-TV

Midwest (North Dakota, South Dakota, Minnesota, Iowa, Nebraska, Kansas, Missouri, Arkansas, Oklahoma, Texas, and Louisiana):
American College Testing Program
Conduit
Dallas County Community College District
Dallas Independent School District
East Texas State University
Great Plains National Instructional Television Library
University of Iowa
University of Mid-America
Mid-America Vocational Curriculum Consortium
Minnesota Educational Computing Consortium
University of Missouri
Oklahoma Department of Vocational and Technical Education
Robbinsdale Area Schools
State Fair Community College
University of Texas at Austin

Mountain (Montana, Idaho, Wyoming, Utah, Colorado, New Mexico, Arizona, and Nevada):
University of Arizona
Brigham Young University
University of Colorado
Utah State University Foundation

Pacific (Washington, Oregon, California, Alaska, and Hawaii):
Alameda County Schools
Association for Continuing Education
University of California
California Polytechnic State University
Clovis Unified School District
Coast Telecourses
Mt. San Jacinto College

A24

For over 30 years,

instructors have welcomed VEP teaching materials into their classrooms. Today, innovative teachers continue to choose VEP materials for the best values in Vo-Ag teaching aids.

Your Students Still Deserve The Best

Your new 1982 catalog offers over 800 items to make teaching easier and more effective. Just look at these great features

- over 35 new products
- an expanded format for easier reading
- a wide variety of award-winning materials — everything from animal science to shop safety
- and a TOLL FREE number for time-saving phone orders

And of course VEP still offers a no-risk, money-back guarantee on all orders.

1982
CATALOG
of Instructional Materials
for Agricultural Educators

Just call
1-800-235-4146
TOLL FREE
for your free 1982 VEP catalog today!

VEP
Vocational Education Productions

CALIFORNIA POLYTECHNIC STATE UNIVERSITY'S Vocational Education Productions service operates through a university nonprofit corporation. (See page 14 for a complete description of the university's activities.)

Reprinted with permission from the American Vocational Association

NAVA 31
A25

IF YOU DON'T KNOW COAST
YOU DON'T KNOW EDUCATION

1: **Coast Telecourses** offers more adult level initial learning systems than any other producer/distributor in North America

2: **Coast Telecourses** are used at more than 1000 locations throughout North America

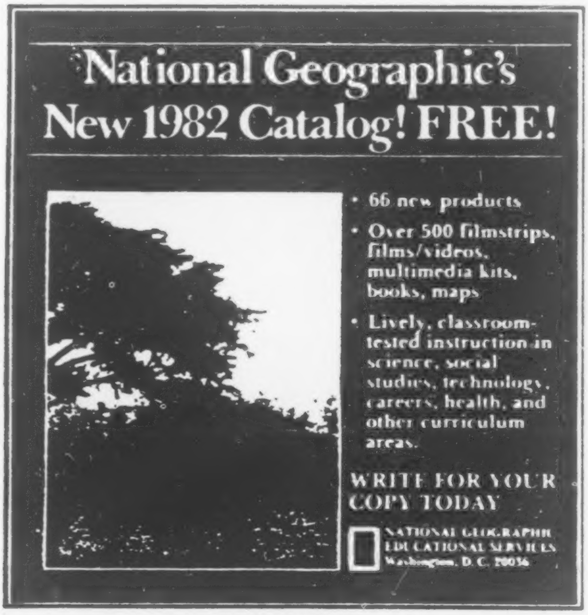
3: **Coast Telecourses** are available in 1/2, 3/4, or 2 formats for use in schools, colleges, universities, libraries, industry education, cable television, broadcast television, military programs and correctional facilities

4: **Coast Telecourses** are shown on PBS and commercial stations and hundreds of cable television systems. Contact us for our catalog and lease/purchase information

Chip Harris—Coast Telecourses (714) 962-8861
10231 Slater Avenue, Fountain Valley, California 92708

INQUIRY CARD NO 121

In addition to selling nationwide, COAST TELECOURSES offers production services in competition with for-profit production companies. (See page 15 for a complete description of their activities.)



National Geographic's New 1982 Catalog! FREE!

- 66 new products
- Over 500 filmstrips, films/videos, multimedia kits, books, maps
- Lively, classroom-tested instruction in science, social studies, technology, careers, health, and other curriculum areas.

WRITE FOR YOUR COPY TODAY

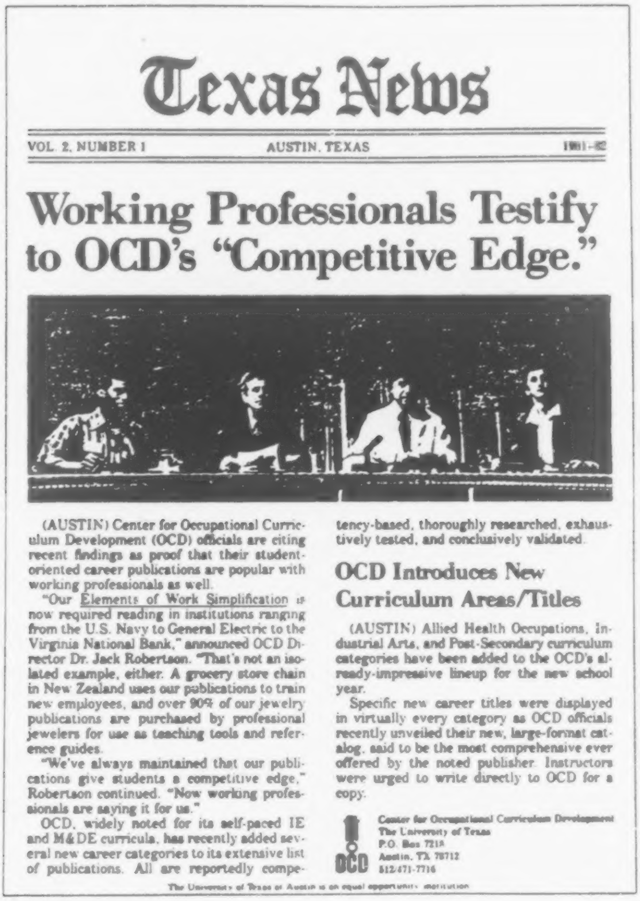
NATIONAL GEOGRAPHIC
EDUCATIONAL SERVICES
Washington, D.C. 20036

INQUIRY CARD NO 136

The NATIONAL GEOGRAPHIC SOCIETY, a nonprofit organization, is a major seller of A-V software. Most materials are unrelated to the Society's research and expeditions. (See page 18 for a complete description of the Society's activities.)

A26

36 NAVA



Texas News

VOL. 2, NUMBER 1 AUSTIN, TEXAS 1981-82

Working Professionals Testify to OCD's "Competitive Edge."

(AUSTIN) Center for Occupational Curriculum Development (OCD) officials are citing recent findings as proof that their student-oriented career publications are popular with working professionals as well.

"Our Elements of Work Simplification is now required reading in institutions ranging from the U.S. Navy to General Electric to the Virginia National Bank," announced OCD Director Dr. Jack Robertson. "That's not an isolated example, either. A grocery store chain in New Zealand uses our publications to train new employees, and over 90% of our jewelry publications are purchased by professional jewelers for use as teaching tools and reference guides.

"We've always maintained that our publications give students a competitive edge," Robertson continued. "Now working professionals are saying it for us."

OCD, widely noted for its self-paced IE and M&DE curricula, has recently added several new career categories to its extensive list of publications. All are reportedly competency-based, thoroughly researched, exhaustively tested, and conclusively validated.

OCD Introduces New Curriculum Areas/Titles

(AUSTIN) Allied Health Occupations, Industrial Arts, and Post-Secondary curriculum categories have been added to the OCD's already-impressive lineup for the new school year.

Specific new career titles were displayed in virtually every category as OCD officials recently unveiled their new, large-format catalog, said to be the most comprehensive ever offered by the noted publisher. Instructors were urged to write directly to OCD for a copy.

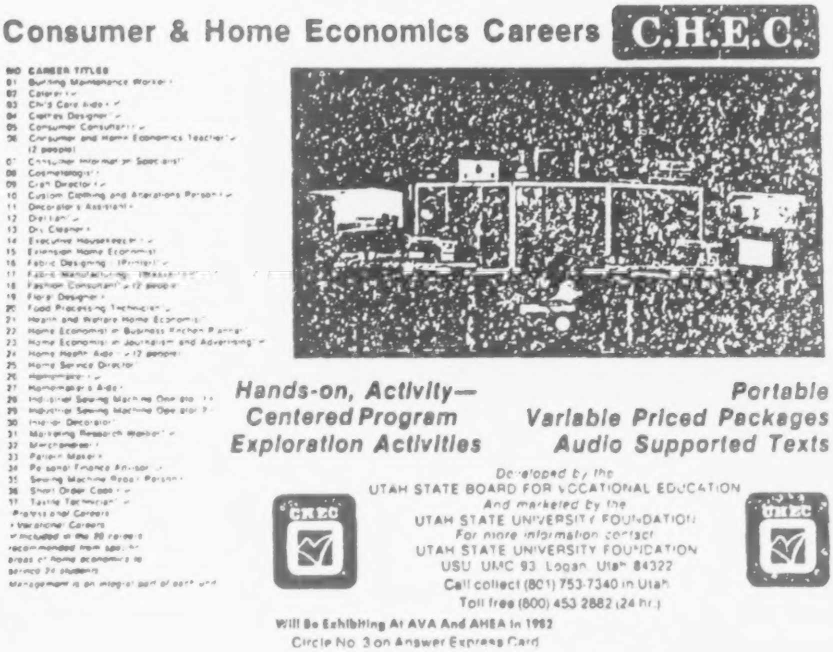
OCD
Center for Occupational Curriculum Development
The University of Texas
P.O. Box 7218
Austin, TX 78712
512/471-7716

The University of Texas at Austin is an equal opportunity institution

Circle No. 147 on Reader Inquiry Card

"We must rely on sales to keep our Center in operation," says the UNIVERSITY OF TEXAS at Austin. (See page 19 for a complete description of the university's activities.)

A27
NAVA 37



Consumer & Home Economics Careers C.H.E.C.

NO CAREER TITLES
01 Building Maintenance Worker +
02 Caterer + ✓
03 Child Care Aide + ✓
04 Clothes Designer * ✓
05 Consumer Consultant * ✓
06 Consumer and Home Economics Teacher * ✓ (2 people)
07 Consumer Information Specialist *
08 Cosmetologist +
09 Craft Director + ✓
10 Custom Clothing and Alterations Person + ✓
11 Decorator's Assistant +
12 Dietitian * ✓
13 Dry Cleaner +
14 Executive Housekeeper + ✓
15 Extension Home Economist *
16 Fabric Designing (Printer) * ✓
17 Fabric Manufacturing (Weaver) *
18 Fashion Consultant * ✓ (2 people)
19 Floral Designer +
20 Food Processing Technician + ✓
21 Health and Welfare Home Economist *
22 Home Economist in Business Kitchen Planner *
23 Home Economist in Journalism and Advertising * ✓
24 Home Health Aide + ✓ (2 people)
25 Home Service Director *
26 Homemaker + ✓
27 Homemaker's Aide +
28 Industrial Sewing Machine Operator 1 +
29 Industrial Sewing Machine Operator 2 +
30 Interior Decorator *
31 Marketing Research Worker * ✓
32 Merchandiser +
33 Pattern Maker +
34 Personal Finance Advisor + ✓
35 Sewing Machine Repair Person +
36 Short Order Cook + ✓
37 Textile Technician * ✓

*Professional Careers
+ Vocational Careers
✓ Included in the 20 careers recommended from specific areas of home economics to service 24 students
Management is an integral part of each unit

Hands-on, Activity—Centered Program
Exploration Activities

Portable
Variable Priced Packages
Audio Supported Texts

Developed by the
UTAH STATE BOARD FOR VOCATIONAL EDUCATION
And marketed by the
UTAH STATE UNIVERSITY FOUNDATION
For more information contact
UTAH STATE UNIVERSITY FOUNDATION
USU UMC 93 Logan, Utah 84322
Call collect (801) 753-7340 in Utah
Toll free (800) 453 2882 (24 hr.)

Will Be Exhibiting At AVA And AHEA In 1982
Circle No. 3 on Answer Express Card

UTAH STATE UNIVERSITY FOUNDATION advertises that "all revenues will go . . . to cover costs . . . with whatever is leftover channeled back to Utah State University . . ." (See page 19 for a complete description of the Foundation's activities.)

Reprinted with permission from the American Vocational Association

Example #2

Dominican Hospital, a not-for-profit Corporation located in Santa Cruz County, is advertising to its member patients and to any and all out patients, that the filling of prescription drugs can be done at the hospital pharmacy at a significant savings over the usual retail price.

The following explanation illustrates the tax-exempt status abuse, and the attached statement is from the President Elect of the California Pharmacy Association who is also a commercial community pharmacist.

A drug manufacturer furnishes Nitroglycerine Patches to Dominican Hospital for approximately 30¢ for a case of 30 or 1¢ per patch. The hospital sells this patch to the public for $35.00 per case of 30, realizing a profit of approximately $34.70.

The community retail pharmacist buys this same patch from the manufacturer for $34.40 per case or $1.15 for each patch. If the pharmacy sold this product at the same price as the hospital, the "profit" would be 50 taxable cents.

evidence attached B1-B11
mail order pharmacy drugs

page 3

example B1

June 17, 1987

Dear Alice:

The problem that Pharmacy faces due to unfair competitive practices from Hospitals, both Non-profit and profit, is a very serious one which will have grave consequences on the delivery of healthcare in America. When these practices occur and we are sure of the illegality of the practice our only recourse is through the Courts which is very costly and time consuming and usually doesn't really stop the practice.

In my area a Hospital, non-profit, recently started a program called Share-Care for Senior Citizens. As an added benefit to the members of this program the hospital began advertising that their members could have there prescriptions filled at the hospital pharmacy at a savings over usual retail prices. This Hospital did not at that time have an outpatient pharmacy and was filling these prescriptions with contract, drugs obtained because of non-profit status ability to get reduced costs through a bidding process, medications. The price differential will vary from 50 to 95% cheaper than is available to the community pharmacy practice. An example of the price differential is Nitroglycerine Patches, to treat angina pain, which the Hospital can obtain for 1 cent a piece and the community pharmacist pays $34.60 for 30 patches or $1.15 each. This Hospital sells these patches to their members for $35.00 for 30 which would give them a profit of $34.70. The Community Pharmacist would make 40 cents if the same price was charged to the patient.

According to Robinson-Patman and later Portland Retail Druggists vs. Abbott Labs. preferentially priced medications purchased by non-profit hospitals can only be used for certain class of patient or person. Walk-in patients are strictly excluded from this usage due to an unfair competitive advantage which the hospital would have. In our case the Hospital has set-up a class of patient called "certified outpatient" to circumvent the law. There is no such classification commonly used in healthcare. There is no time tie-in to the hospital or any other qualifications to belong to this class of people. My own mother, who has not been a patient in this hospital in at least the last 12 years and maybe even longer, was given this status immediately.

Hospitals can operate an outpatient pharmacy but are required to maintain a separate inventory the was purchased at the regular cost, according to Robinson-Patman. An even

B3

greater problem is that even For Profit Hospitals get preferentially priced drugs now as an extention of the original intent which was to help the hospitals defray some of the cost of caring for indigent patients. In 1936 when Robinson-Patman was enacted this would seem prudent, but today with all the Social Programs available it hardly seems necessary for hospitals to get special prices at all expecially when the drug portion of a hospital bill is so exorbitantly overpriced. The charge of $1.00 to $1.50 for a Tylenol tablet is a just outrageous.

More and more Hospitals are entering this market trying to make up for DRG's and just to generate more profit. I have no problem with Hospitals being in the outpatient business but I feel that they should have to pay the same price for the ingredients that the Community Pharmacist must pay if they are to compete in the same market. It is my feeling that most Hospitals cannot compete in our market because they are used to the margins they use in the inpatient area and cannot be efficient enough to compete. They know nothing about Delivery, Charge Accounts and generally caring for the outpatient population.

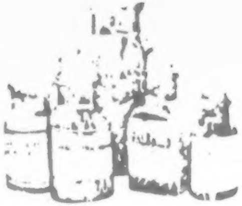
This very serious problem is growing and I have recently heard the the 3 Hospitals in our area are planning to set-up as a group Home Healthcare and DME services for the entire Santa Cruz County. The advantage of being able to direct these patients to their service would enable them to put most of the competition out of business in a short period of time.

Healthcare is changing in America and the use of Unfair Competitive Practices is playing a large role in the demise of the Community Pharmacist. The Pharmacist that knew you and your healthcare needs is becoming a rarity instead of the rule as it was in the past. We are being forced into mass production of healthcare and the patient is suffering. No one seems to care that the patient is losing the choice of where he will get his medications and from whom. The confidence that has been placed in the Community Pharmacist is being usurped by bottom line mentality. There are ways to cut Healthcare costs without harming the patient. If something is not done now soon there will be no choice and we will move further into becoming a second rate nation when it comes to the provision of healthcare.

Sincerely,

N. Bruce Bettencourt

NOR-BAR Ind., Inc.
222-D Mt. Hermon Road Scotts Valley, CA 95066



SAN JOSE CA 951
PM
22 JUN
1987

give
The United Way

ALICE REED
91 JACKSON
HAYWARD, CA. 94544

B4

AARP NEWS BULLETIN

Vol. 28, No. 7 *Washington, D.C.* *July-August 1987*

Off and running

AARP/VOTE acts to sharpen '88 debate

AARP/VOTE has launched a drive to educate voters and initiate debate on issues of concern to older Americans in the 1988 presidential campaign.

Now getting underway, the effort will include presidential forums, in which AARP members will question leading candidates, a survey of candidates' opinions on key issues, and publication of booklets that describe candidates' views on major issues affecting older persons and the nation.

The drive, kicked off by a July press conference in Washington, will be conducted by AARP/VOTE, the non-partisan voter education arm of AARP.

"Our goal is threefold," says Bob Canavan, director of AARP/VOTE. "First, we want to educate our members about issues that concern them. Secondly, we want to have the candidates specifically address our issues and, thirdly, we will seek to have the Republican and Democratic party platforms address the issues of importance to AARP and its members."

Initially, AARP/VOTE will center its activities on the presidential contests in Iowa, which holds caucuses on February 8, and New Hampshire, which conducts its primary on February 16.

By October, AARP/VOTE will have trained volunteers at eight regional workshops around Iowa. AARP/VOTE hopes to train about 1,000 volunteers to serve as caucus leaders.

The workshops will be followed by a media campaign highlighting central AARP themes—health care costs, income security and long-term care—and, on November 18-19, a presidential forum in DesMoines.

Through mailings and phone calls,

continued on page 4

12
White House in 88
D.C. or Bust
R-G

Medicare's rosier outlook exacts toll

First, the good news about the financial outlook for Medicare.

The annual report of Medicare's Board of Trustees declares "significant new gains" in the near-term solvency of the program. The Hospital Insurance Trust Fund should remain solvent through the year 2002 under current policies and with "moderate" economic assumptions. That's six more years than the outlook just one year ago—and 16 years more than the projections of 1981 that led to reforms in Medicare's financing.

Next, the more sobering news.

Those gains in solvency were made largely at the expense of Medicare enrollees. According to a General Accounting Office (GAO) report issued at the same time as the trustees' report, five pieces of legislation passed in the 1980s apparently succeeded in slowing the growth of Medicare costs through fiscal 1985.

Key reasons? Out-of-pocket expenses for Medicare enrollees, figured on per capita basis, increased about 49 percent under Part A (from $84 to $125) during 1980-85, and about 31

continued on page 11

Coming: credit union for members

AARP is sponsoring development of a major new service for members: The AARP Federal Credit Union.

The new entity will be a cooperative, federally insured financial service designed expressly to meet AARP members' needs and operated for their benefit. One objective is to enable members to receive preferred rates of interest on savings, checking account and time deposits.

Another purpose is to make a low-interest credit card available, especially to those members who have had difficulty qualifying for such a card because they are retired.

"Through this new service, we hope to enlarge substantially the financial options available to older Americans," says AARP Executive Director Cyril F. Brickfield. "It will especially aid lower-income persons and those who are penalized because they aren't eligible for credit."

AARP Federal will serve members around the country through the mail, over the telephone and via automatic teller machines. Now in the organizational stage, AARP Federal received its government charter in late April. It will be piloted on a limited basis in four areas of the country this fall, and then gradually expanded in 1988 to be available to the entire membership.

IN THIS ISSUE

AARP health care volunteers carry 'first aid' message to Capitol Hill 2

Florida retirees deliver medical services—free. 6

Support builds for nursing home reform. 8

A publication of the American Association of Retired Persons

AARP NEWS BULLETIN®
Vol XXVIII, No. 7 July/August 1987

AARP News Bulletin (ISSN-0010-0200) is published monthly except August by the American Association of Retired Persons, 3200 E. Carson St., Lakewood, Calif. 90712, with editorial offices at 1909 K St. N.W., Washington, D.C. 20049 (telephone [202] 872-4700.) Annual membership dues are $5, which includes $5 cents for annual subscription to the *AARP News Bulletin*.

Second-class postage paid at Lakewood Calif., and at additional mailing offices. POSTMASTER: Send Form 3579 to P.O. Box 199, Long Beach, Calif. 90801.

Entire contents Copyright® 1987 by the American Association of Retired Persons.

Executive Director
CYRIL F. BRICKFIELD
Publishing Director
ROBERT E. WOOD
Editor
ELLIOT CARLSON
Managing Editor
BILL CRAWFORD
Production Editor
LEAH K. GLASHEEN
Editorial Assistant
CATHY L. HALL
Advertising Director
JOSEPH E. (PETER) HANSON JR.
Advertising Offices
Maturity Magazines Group
420 Lexington Ave
New York, N.Y. 10170

Bill providing 'catastrophic' care advances

The drive to protect older Americans against the cost of acute catastrophic illness advanced another step when the Senate Finance Committee approved such legislation.

The measure, introduced by Finance Committee chairman Lloyd Bentsen (D-Texas), would pay for all Medicare-covered hospital and doctor bills for beneficiaries after a $1,700 annual deductible is met.

The bill resembles legislation passed earlier by the House Ways and Means Committee. Both the House and Senate bills provide substantially greater benefits than the "catastrophic" care proposal advanced earlier this year by the Reagan Administration.

Because of pressure brought to bear by AARP and other organizations, the Ways and Means Committee considerably broadened the original catastrophic bill before it. It made changes that, among other things, expand the Medicare home health care benefit, improve protections for low-income individuals and improve mental health coverage.

While AARP applauded these changes, it's now pressing the House of Representatives to go further and fill a number of gaps that remain in Medicare's coverage of catastrophic illnesses. Already there is some movement in these areas.

For example, the Ways and Means Committee is considering a proposal that would add an out-patient prescription drug benefit to the catastrophic plan. Under this proposal, Medicare would pay 80 percent of such drug costs after beneficiaries meet a $500 annual deductible.

Meantime, the House Energy and Commerce Committee is considering a prescription drug plan proposed by Rep. Henry Waxman (D-Calif.) as well as provisions that would provide respite care and protect spouses from impoverishment due to Medicaid's "spend-down" rules.

AARP strongly supports these proposals and, officials say, it will seek to expand the Senate bill to meet basic AARP objectives.

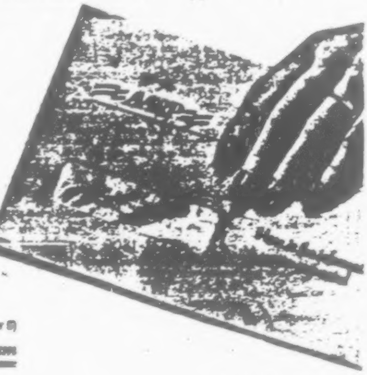
To finance its somewhat more modest benefit package, the Senate bill would impose a flat $4 monthly increase on beneficiaries—an amount in addition to the existing Part B premium. Also, the Senate bill would supplement this amount with a sliding-scale premium that would be based on the income of beneficiaries. The higher the individual's earned income, the higher his payment would be. Under one estimate, the amount could go as high as $800 a year in 1988. The extra amount would be calculated in conjunction with the beneficiary's tax return.

The Ways and Means Committee also decided to base its benefit package on a new double-premium system. First, all beneficiaries would pay a "basic" premium for catastrophic coverage of $1 per month starting in 1990, rising to $1.50 in 1991. This would be on top of the existing Part B premium.

3

Also, beneficiaries would pay a mandatory "supplemental" premium based on income. Under this approach, most families with incomes under $15,000 would not have to pay any supplemental premium. With both the House and Senate bills, older persons who pay no federal income tax would pay nothing for the additional coverage beyond the flat premium.

Discussing the Ways and Means bill, AARP officials viewed its premium financing method as "far from perfect" but closer to traditional social insurance concepts than an earlier proposal to tax the insurance value of Medicare.



One quick call puts information about the new AARP Nursing Home and Home Health Care Plan right in your hands.

Important long-term health care breakthrough.

One of the biggest worries about long-term nursing care—either in a nursing home or in your own home—is high costs.

That's why this new plan has been designed by The Prudential to help protect you from the potentially heavy drain of long-term nursing home and home health care expenses—expenses not likely to be covered either by Medicare or your private insurance.

Pays benefits for up to three years.

This special new plan will help pay for all levels of nursing home care, including custodial, for up to three years. Plus, it helps pay for home health care visits. However, to keep the rates reasonable, there are certain eligibility requirements.

Call now to receive this important information kit. This is a limited offer, so we must receive your application by August 31, 1987. You'll also receive AARP's valuable reference guide: "Making Wise Decisions for Long-Term Care."

This plan is available in most states.

1-800-245-1212 (Ask for Operator 8)

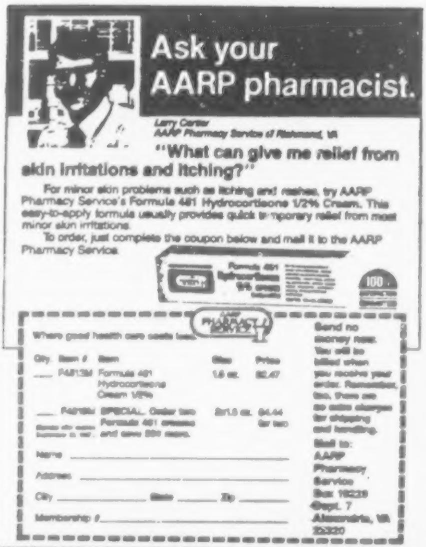
AARP Group Health Insurance Program

P.O. Box 7000
Allentown, PA 18175-0400

The Prudential

D61

4



Ask your AARP pharmacist.

Larry Carter
AARP Pharmacy Service of Richmond, VA

"What can give me relief from skin irritations and itching?"

For minor skin problems such as itching and rashes, try AARP Pharmacy Service's Formula 461 Hydrocortisone 1/2% Cream. This easy-to-apply formula usually provides quick temporary relief from most minor skin irritations.

To order, just complete the coupon below and mail it to the AARP Pharmacy Service.

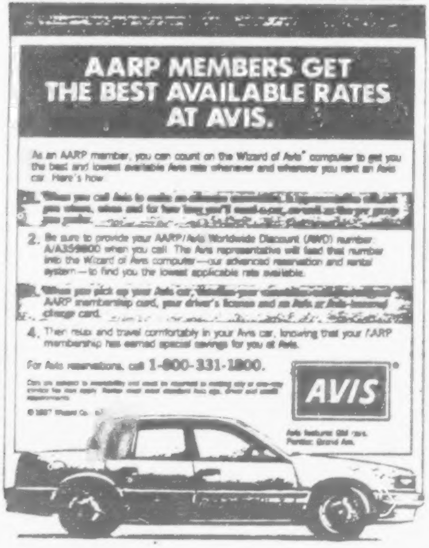
Where good health care costs less.

Qty.	Item #	Item	Size	Price
___	P481354	Formula 461 Hydrocortisone Cream 1/2%	1.5 oz.	$2.47
___	[illegible]	SPECIAL. Order two Formula 461 creams and save [illegible]	2/1.5 oz.	$4.44 for two

Name ____
Address ____
City ____ State ____ Zip ____
Membership # ____

Send no money now. You will be billed when you receive your order. Remember, too, there are no extra charges for shipping and handling.

Mail to:
AARP
Pharmacy
Service
Box 19229
Dept. 7
Alexandria, VA
22320



AARP MEMBERS GET THE BEST AVAILABLE RATES AT AVIS.

As an AARP member, you can count on the Wizard of Avis® computer to get you the best and lowest available Avis rate whenever and wherever you rent an Avis car. Here's how.

1. When you call Avis to make an advance reservation, [illegible] you where, when and for how long you'll need a car, as well as the car group you prefer.
2. Be sure to provide your AARP/Avis Worldwide Discount (AWD) number: A/A354800 when you call. The Avis representative will feed that number into the Wizard of Avis computer—our advanced reservation and rental system—to find you the lowest applicable rate available.
3. When you pick up your Avis car, [illegible] AARP membership card, your driver's license and an Avis or Avis-honored charge card.
4. Then relax and travel comfortably in your Avis car, knowing that your AARP membership has earned special savings for you at Avis.

For Avis reservations, call 1-800-331-1800.

[illegible]

© 1987 Wizard Co. [illegible]

AVIS

Avis features GM cars. Pontiac Grand Am.

EXECUTIVE DIRECTOR'S REPORT

. By Cyril F. Brickfield

In Washington, D.C., nearly everyone claims to be a "public servant." But former Secretary of Health, Education and Welfare (HEW) Wilbur Cohen—who died in May at the age of 73—truly earned that title.

Cohen was a government employee, a teacher and a writer. But most of all he was an advocate—for older Americans, for children and for the poor of all ages.

He helped create Social Security and, more than 50 years later, was still a forceful, articulate spokesman for that and other programs to improve the quality of life for all Americans.

"I don't see for the life of me why anyone over the age of 65 has to live in poverty," he said in 1968. And nearly 20 years later, just prior to his death, he was writing columns for *The New York Times* and other newspapers about the inequities of our current health system.

Cohen came to Washington in 1934, at the age of 21, to help draft the most far-reaching and successful piece of social legislation in our nation's history—Social Security. He called that "a rather heady experience," and remained with the Social Security Administration for the next 22 years to help make sure the program worked.

In 1961, he became one of the older "New Frontiersmen." President Kennedy appointed him assistant HEW secretary for legislation. In 1965, he became under secretary of HEW, and in 1968, was appointed HEW secretary by President Johnson.

During those seven years, Cohen helped obtain Congressional passage of some of the most sweeping legislation of our time. Foremost among these measures—from our standpoint—were Medicare and Medicaid. But Cohen believed in the interdependence of generations. That's why the "father of Medicare" was also involved in the creation of the National Institute of Child Health and Human Development and the passage of the Elementary and Secondary Education Act of 1965 and the Higher Education Act.

It wasn't easy to get Congress to adopt such far-reaching legislation. But, as a friend once remarked: "Wilbur was a master magician in getting what he wanted—he understood the system and could find the pathway through the maze."

After leaving the government, Cohen continued his public service in the educational arena, becoming a professor at the University of Michigan and, later, at the Lyndon Johnson School of Public Affairs at the University of Texas. He gladly shared his experience and expertise with students and scholars of all ages; he thoroughly enjoyed helping to educate a new generation of Americans.

And he remained a "people's advocate," serving with boundless energy and distinction as co-chairman of SOS, a national coalition formed to protect Social Security.

Cohen never had time to retire. He was "public servant" until the day he died. And as he served the public, he enriched the lives of all of us who had the privilege of working with him.

We honor him best by keeping the programs he cherished strong and secure for future generations of Americans.

AARP/VOTE

continued from page 1

AARP/VOTE will urge Iowa AARP members to attend the February 8 caucuses. The purpose will not be to endorse particular candidates. "Our goal is to have AARP members bring AARP/VOTE-sponsored resolutions for adoption at each Republican and Democratic caucus," Canavan says.

A similar effort will be waged in New Hampshire, where forums have been scheduled for this fall to inform AARP members about health care issues. AARP/VOTE will ask members there to raise specific questions about AARP issues when they meet with presidential candidates in town forums.

For the "Super Tuesday" primary on March 8, when 20 states will either hold presidential primaries or caucus votes, AARP/VOTE will conduct a separate voter education effort. It will include media campaigns and the mailing of voters' guides to members. "We expect to be heavily involved in Alabama, Kentucky, Florida and at least two other states in the March 8 primary," Canavan says. AARP/VOTE will also be active in the remaining primary and caucus states on a "targeted basis."

88

8

AARP TRAVEL SERVICE

OUTSTANDING TRAVEL VALUES

American Hawaii Cruises . . . Paradise for Less
Save 15% to 25% on 7-day Hawaii cruises aboard the newly refurbished *Independence* or *Constitution*. Reserve six months in advance with the AARP Travel Service and get a free 2-night pre- or post-cruise Honolulu stay.
Year-round — Check code CH

Mexico . . . Come and Say Ole'
Escorted Tours to Mexico's historic cities. Hotels, AARP Tour Manager, and many meals included. Guadalajara and/or Mexico City Hosted Holidays with AARP Hosts, hotels, and optional Puerto Vallarta extension.
September to April — Check codes L or M

Delta Queen . . . Steamboatin' In Style
AARP members can cruise the Mississippi or Ohio Rivers and save from $86 to $696 per person. Twenty departures, 4- to 10-night duration.
Year-round — Check code CU

Rose Parade . . . New Year's Holiday
Excellent reserved seats for the famous Pasadena Rose Parade. Five-day package includes Myron Floren dinner dance, sightseeing, first-class hotel, New Year's Eve ball with Horace Heidt, Jr. Pre- and post-tour options.
December 29, 1987, to January 2, 1988 — Check code S

Orient Hosted Holidays . . . A Great Value
Simply an outstanding value. Round-trip air fare included to your choice of Tokyo, Singapore, Hong Kong, Bangkok, Seoul, Taipei, Bali, and Malaysia. Enjoy first-class hotels, daily breakfasts, plus AARP Hosts. One week Hong Kong for only $898 per person.
Year-round — Check code Q

South Pacific or India . . . Exotic Values
Six Escorted Tours to the South Pacific include our special Circle Pacific tour featuring the Orient, too. Royal India and Nepal tour also visits Singapore and Hong Kong. New for 1988: India Palaces tour and tours featuring Tibet. All include special meals, round-trip air fare, hotels, and AARP Tour Manager.
Year-round — Check codes K or U

Europe Hosted Holidays . . . Variety and Value
Extended vacations in a wide selection of resorts and cities like Nice and Cannes on the Riviera, London, Paris, Edinburgh, Vienna, Spain's Costa del Sol, Majorca, and Madrid, Portugal's Tenerife and Cascais. AARP Host, choice of accommodations, round-trip transatlantic air fare, too.
November 1987 to May 1988
Check code G

AARP TRAVEL SERVICE
PROVIDED BY OLSON-TRAVELWORLD, LTD

YES, I'm interested in the brochures checked (limit 3, please)

EUROPE
☐ E - [illegible]
☐ G - [illegible]
☐ D - [illegible]
☐ H - [illegible]

USA/CANADA
☐ A - [illegible]
☐ D - [illegible]
☐ F - [illegible]

SPECIAL EVENTS
☐ [illegible]
☐ S - [illegible]
☐ [illegible]

CARIBBEAN/BERMUDA
☐ V - [illegible]
☐ W - [illegible]

HAWAII/MEXICO
☐ B - [illegible]
☐ C - [illegible]
☐ L - [illegible]
☐ M - [illegible]

ORIENT/PACIFIC
☐ J - [illegible]
☐ Q - [illegible]
☐ K - [illegible]
☐ U - [illegible]

CRUISES
☐ CA - [illegible]
☐ CB - [illegible]
☐ CC - [illegible]
☐ CE - [illegible]
☐ CH - [illegible]
☐ CX - [illegible]
☐ CO - [illegible]
☐ CS - [illegible]
☐ CP - [illegible]
☐ CT - [illegible]
☐ CW - [illegible]
☐ CU - [illegible]

[illegible] ☐ 1987 ☐ 1988

Membership # ______ Phone # (___) ______
PLEASE PRINT
Name ______
Address ______
City ______ State ______ Zip ______

Mail to: AARP Travel Service
P.O. Box 58997, Los Angeles, CA 90058
[illegible]

Suddenly, nursing home reform: 'an idea whose time has come'

After shying away from the subject for years, Congress seems about to enact comprehensive legislation intended to improve the quality of services delivered by nursing homes.

Such action is long overdue, says AARP volunteer Marjory Blood, who recently urged lawmakers to pass such a measure. "Unfortunately, nursing home residents continue to receive poor quality care in far too many long-term care institutions," she told a Congressional panel.

Support for reform legislation burgeoned last year when the Institute of Medicine (IOM), a component of the National Academy of Sciences, issued a landmark report on "Improving the Quality of Care In Nursing Homes."

The IOM concluded, among other things, that the quality of life in many nursing homes isn't satisfactory, and it went on to call for more effective government regulation of nursing homes.

In a major step, 20 organizations coordinated by the National Citizens Coalition for Nursing Home Reform this spring addressed key nursing home quality issues. Calling themselves the "Campaign for Quality Care in Nursing Homes," the groups released "consensus" position papers and "supplemental" position papers on those issues.

Drawing on the IOM study and the Coalition's work, lawmakers have started advancing their own reform proposals. Sen. George Mitchell (D-Maine) has taken the lead in the Senate by introducing the "Medicare and Medicaid Nursing Home Quality Amendments" (S. 1108).

Meantime, Rep. Henry Waxman (D-Calif.) put forward the "Medicaid Nursing Home Quality Amendments" (H.R. 2270), along with John Dingell (D-Mich.). Rep. Fortney Stark (D-Calif.) is expected to introduce a Medicare and nursing home reform bill.

For its part, AARP supports the overall intent of these bills and it already has testified in behalf of the Waxman-Dingell measure.

But the Association is also working to strengthen these bills. One change sought by most proponents of reform are training standards for nurses aides. Right now, testified Blood, the vast majority of nurses aides in nursing homes are untrained and unskilled.

To upgrade these individuals, the Mitchell bill would require a minimum of 100 hours of training for nurses aides, while the Waxman-Dingell measure simply would mandate a tougher training program, without specifying hours. AARP, however, wants a 160-hour nurses aid training program, along with competency testing.

Another primary concern is that there simply aren't enough nurses in nursing homes. In intermediate care facilities (ICFs), for example, all that is required is that a licensed practical nurse (LPN) be on the day shift seven days per week. Thus, under federal standards, ICF residents can be left in the care of untrained nurses aides for 16 hours per day, and an unsupervised LPN for the other eight hours.

Nursing homes don't have enough nurses, says AARP's Blood

Staffing requirements for skilled nursing facilities (SNFs) are only somewhat better, as they require a registered nurse (RN) to be on duty for only eight hours per day seven days a week with an LPN on staff 24 hours each day. Both the Mitchell and Waxman-Dingell measures would raise the ICF requirement to the SNF standard. AARP, however, thinks that doesn't go far enough. It would require both ICFs and SNFs to have 24-hour, seven-day-a-week RNs on staff.

"Nursing homes do not have enough professional nurses on staff," testified Blood, who is a member of AARP's National Legislative Council and serves as chairman of the advisory committee of Maine's Long-Term Care

B9

Ombudsman Program. "Minimum requirements for intermediate care facilities are particularly inadequate. All homes should be required to have at least one registered professional nurse on staff" at all times.

A major problem over the years is that many nursing homes have tended to balk at the admission of those patients whose bills are paid for by Medicaid. Such patients haven't always been admitted because nursing homes prefer private pay patients who are billed at higher rates.

Regarding such discrimination, there is consensus that transfer and discharge policies and Medicaid covered services should be the same for all residents. Groups disagree on admission policies, however. AARP has offered a compromise that would require homes to admit a "fair share" of Medicaid residents. But so far neither of the two major bills have embraced this approach.

Another difficulty is the insufficient range of both federal and state sanctions available to assure compliance with standards of care.

The Association favors the enforcement approach included in the Waxman-Dingell measure providing for the use of such tools as civil fines and court-appointed receivers.

"Receivership is particularly important for use as a threat to facilities that have failed to respond to other sanctions," Blood said. "In those instances where owners threaten to 'take the money and run' rather than comply with state and federal standards, receivership permits gradual relocation of residents—at the owners' expense, in order not to jeopardize residents' health, safety and welfare."

AARP also believes assurance should be provided so states use their enforcement authority effectively.

Right now, there's no way to tell how successful AARP will be in its effort to strengthen nursing home reform legislation. Congressional sources point out the changes sought by AARP would push up the cost of such legislation.

Yet, whatever happens, Congress seems likely to include some form of nursing home reform in this year's budget reconciliation bill. The reform is needed, says Senator Mitchell. Recently, he pointed out that many nursing homes have proven that they can provide care that is sensitive and comprehensive. "Despite this progress," he said, "the evidence of continued substandard care in a substantial number of nursing homes has continued."

"Time has come for the Medicaid program to stop paying for bad care and with last year's IOM report," Waxman recently recently declared, "we now have a framework through which to make the needed changes in an orderly way."

Humana buys troubled Florida HMO

U.S. Circuit Judge William Gary has approved a plan that permits Humana Inc. to acquire certain assets of International Medical Centers (IMC), the financially-troubled health maintenance organization based in Florida.

Florida Insurance Commissioner Bill Gunter submitted the proposal after reaching agreement with the Health Care Financing Administration (HCFA). HCFA, which administers Medicare, notified IMC on May 1 that it intended to terminate its contract with the HMO, effective July 31.

HCFA's action could have affected the many Medicare beneficiaries who depend on IMC for their health coverage. With more than 126,000 Medicare beneficiaries enrolled, IMC represented the largest HMO participating in the Medicare program.

But IMC had been under fire for late bill payments, questionable marketing practices and complaints of illegal screening of Medicare applicants. HCFA last year told IMC it was out of compliance with federal HMO rules. IMC promised to improve, but its problems continued.

After HCFA moved to cancel its contract with IMC, a U.S. judge found the HMO insolvent. It was then taken over by the Florida insurance commissioner, who was named by Judge Gary as the IMC receiver. Shortly afterwards, the commissioner recommended that Humana's proposal to acquire IMC be approved. Humana is a private hospital chain based in Louisville, Ky.

In accepting the plan, in which IMC was liquidated, Gary allowed Humana to acquire the HMO's delivery system and Medicare contract. In return, Humana agreed to place $40 million with the receiver to pay IMC's past debts. It also agreed to place $20 million with the HMO as working capital.

Under the arrangement, HCFA granted Humana a Medicare contract. As a result, Humana will, at least for the remainder of the calendar year, provide Medicare enrollees in IMC with all the benefits and services they received from IMC in the past. Beginning next year, Humana will be free to alter the benefit package for enrollees.

HCFA officials said they were pleased with the outcome. "We're confident that Humana will offer the necessary management, financial and quality assurance to provide quality health care for Medicare beneficiaries," a spokesman said.

Can the AARP Homeowners Insurance Program give you better protection—at a better price?

Mail this coupon and see! You could save 10% to 15% on your homeowners insurance with this AARP Program. Simply complete the form below, then mail. If you qualify, and most AARP members do, The Hartford will send your free, no-obligation Premium Quotation. For faster service, call toll free 1-800-423-4114, 8:00 a.m. to 8:00 p.m. your local time, Monday—Friday, and 8:00 a.m. to 5:30 p.m. on Saturday. We'll quote you rates over the phone and send a written Quotation promptly.

AARP HOMEOWNERS INSURANCE PROGRAM
THE HARTFORD

Mail to: AARP Homeowners Insurance Program, The Hartford Insurance Group, P.O. Box 2986, Hartford, CT 06104-2986

GENERAL INFORMATION CODE [illegible]
Name ______
Address of home to be insured ______
City ______ State ______ Zip ______
Phone ( ) ______ Is this your primary residence? Yes ☐ No ☐
Is business (including farming) conducted on premises? Yes ☐ No ☐
If yes, please specify: ______
Is dwelling a mobile or manufactured home? Yes ☐ No ☐
Is dwelling located in a mobile home park? Yes ☐ No ☐
Please note: Coverage is not available for mobile or manufactured homes.
Do you own or rent? Own ☐ Rent ☐
If you own, do you occupy yourself or rent to others? Occupy ☐ Rent to others ☐ Both ☐
Are you retired? Yes ☐ No ☐
If yes, are you or your spouse employed more than 24 hours per week? Yes ☐ No ☐
Expiration date of current homeowners/renters policy: Mo. ______ Day ______ Yr. ______
Name of your current homeowners insurance company: ______
Are you a policyholder in the AARP Automobile Insurance Program from The Hartford?
Yes ☐ No ☐ If no, check here for information about this AARP Program. ☐

FIRE/SECURITY PROTECTION
Is property located inside city or town limits? Yes ☐ No ☐
If no, name of town providing fire protection: ______
Distance to fire hydrant: Under 1,000 ft. ☐ Over 1,000 ft. ☐
Distance to fire station: Under 5 miles ☐ Over 5 miles ☐
Does your home have smoke detectors? Yes ☐ No ☐
Dead-bolt locks on all exterior doors? Yes ☐ No ☐
Any other professionally installed alarm systems? Yes ☐ No ☐ If yes, please specify type:
Fire ☐ Burglar ☐ Alarm sounds at: Residence ☐ Police Station ☐ Fire Station ☐
Security Office ☐ Other (please specify): ______

LOSS/CLAIM INFORMATION
Have you had any homeowners losses or claims during the last three years? Yes ☐ No ☐
If yes, please list on a separate sheet the date, amount and a description of all losses.

COMPLETE THIS SECTION ONLY IF RESIDENCE IS APARTMENT OR CONDOMINIUM
Are there more than four units per building? Yes ☐ No ☐
Are there full-time security guards in the building or complex? Yes ☐ No ☐
Construction: Wood Frame ☐ Brick/Masonry ☐ Aluminum/Vinyl/Asbestos Siding ☐
Other ______
Household contents (includes personal belongings) coverage amount requested: $ ______

COMPLETE THIS SECTION ONLY IF YOU ARE A HOMEOWNER
Type of dwelling: Single Family ☐ Two-Family ☐ Modular Home ☐
Other (please specify): ______
Year of construction: ______ If dwelling was built before 1935, have the wiring, heating, and plumbing all been partially or fully updated? Yes ☐ No ☐
Construction: Wood Frame ☐ Brick/Masonry ☐ Brick Facing ☐ [illegible]
Aluminum/Vinyl/Asbestos Siding ☐ Other: ______
Construction class: ☐ Economy: Simple design, basic construction.
☐ Standard: Most homes, average to better materials and workmanship.
☐ Custom Built: Superior design, above-average construction.
Please indicate the number of units below. From this information we will compute the estimated replacement cost of your home.
___ Number of full-size rooms (kitchen, dining, living, finished basement, bedrooms, baths, etc.)
___ Number of small rooms (half baths, laundry room, dinette/breakfast nook, mud room, unfinished basement or attic, entrance halls, walk-in closets, dressing rooms, utility rooms, etc.)
A. Please check if applicable:
☐ Central A/C
☐ Aluminum/vinyl siding
☐ Brick/stone exterior walls
☐ Brick/stone veneer
☐ Carport
☐ Attached one-car garage
☐ Attached two-car garage
☐ Built-in two-car garage
☐ Clay tile/slate roof
B. Please indicate number of units:
___ Fireplaces
___ Open porches/decks
___ Enclosed/screened porches
Your estimate of the amount of coverage you will need on your dwelling: $ ______
(Contents coverage amount will be automatically computed based on dwelling coverage amount. If you need special contents coverage, please call the toll-free number above.)

*Currently unavailable in Maine, Canada and U.S. Territories or Possessions. The AARP Homeowners Insurance Program is underwritten by The Hartford Insurance Group [illegible]

9

Future workplace

continued from page 12

Garvin suggests that older workers "master at least the principles of computers, perhaps taking a basic course. This will provide the experience and confidence to learn other technology as it evolves."

(One way to pick up computer literacy skills may be through volunteering. Garvin gives the example of the Colorado Springs, Colo., Police Department, which trains volunteers to enter crime statistics into its computer system.)

WUNDERKIND WIDGETS

'The majority of new jobs require experience, knowledge and people skills. … This is good news for older workers.'

- With large companies cutting back on the number of full-time workers, experts forecast the growth of smaller, younger, highly innovative businesses to provide services to large companies on an as-needed basis—everything from accounting to repair work. These small businesses may be a key source of many new jobs in the near future.

- Consider alternatives to your current career, especially if you want to stay in the community in which you now live. Says Gamse, "If relocating is out of the question because of family obligations or other reasons, take out some 'insurance' to prepare yourself for change. Look around while you have a job. Check the classifieds to get a general idea of the types of jobs and skills businesses in your area are looking for. Call to get an idea of the hourly rate being paid" for different occupations.

- Identify local employment resources *before* you need them. Community colleges often have close ties with local business and industry, and thus offer technical courses that reflect the local job market. And they may offer skills assessment, job search and career exploration courses, and apprenticeship programs. Some serve as small business resource centers for would-be entrepreneurs.

- Don't overlook help offered through state employment offices, religious centers, senior centers, AARP chapters and local public service agencies.

- Build and maintain networks of family, friends and work associates. Stay active and in touch with your field through the local chapter of your trade or professional association.

- Find out about the Job Training Partnership Act (JTPA) in your area. It provides job training to economically disadvantaged persons, displaced workers and others who face significant employment barriers (such as age discrimination). Your governor's office can refer you to the agency overseeing the program in your state.

- Learn to spot signals of change in your community and nationwide by reading business journals, magazines, and newspapers. Other sources of information about economic change include the local chamber of commerce and your city and state's high tech councils.

Finally, know your rights under the Age Discrimination in Employment Act (ADEA) and assert yourself. You have a right to equal opportunity.

The Association publishes several booklets on work-related issues. To receive free copies of these, please see "Get It In Print" on the back page.

☑ Yes, I'd like to find out whether I'll save...and how much... with the AARP Auto Insurance Program from The Hartford!

It's easy to learn exactly how much you might save! Complete the form below, then mail. If you qualify, and over 90% of all AARP members do, we'll provide a quote to compare to your current coverage. Or call toll free 1-800-423-2121, 8:00 a.m. to 8:00 p.m. your local time, Monday–Friday, and 8:00 a.m. to 5:30 p.m. on Saturday. We'll quote you rates over the phone and mail you a written Quotation promptly.

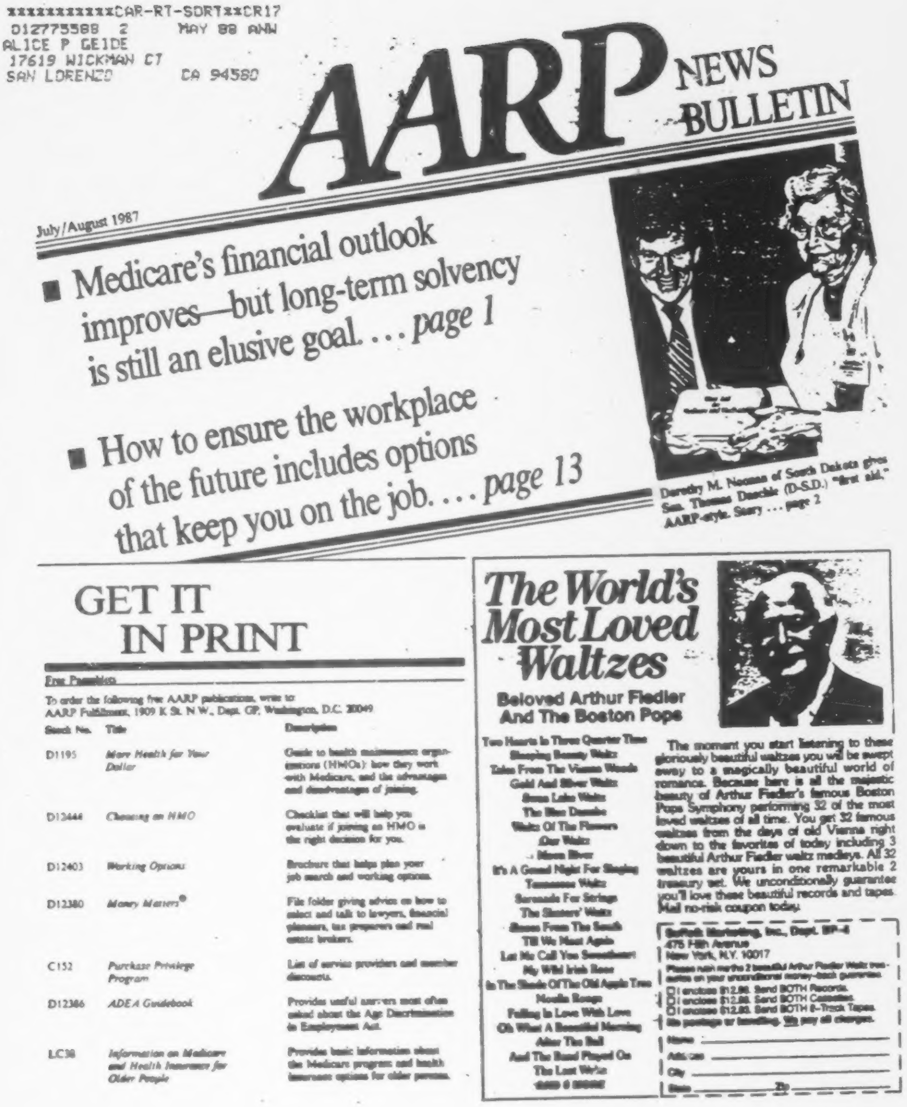
AARP AUTOMOBILE INSURANCE PROGRAM THE HARTFORD

Mail to: AARP Automobile Insurance Program, The Hartford Insurance Group, P.O. Box 2905, Hartford, CT 06104-2905

CAR INFORMATION: [illegible]

DRIVER INFORMATION: [illegible]

B11



```
xxxxxxxxxxxxxCAR-RT-SORTxxCR17
 012775588  2        MAY 88 ANW
ALICE P GEIDE
 17619 WICKMAN CT
SAN LORENZO         CA 94580
```

AARP NEWS BULLETIN

July/August 1987

- Medicare's financial outlook improves—but long-term solvency is still an elusive goal. . . . *page 1*
- How to ensure the workplace of the future includes options that keep you on the job. . . . *page 13*

Dorothy M. Noonan of South Dakota gives Sen. Thomas Daschle (D-S.D.) "first aid," AARP-style. Story . . . page 2

GET IT IN PRINT

Free Pamphlets

To order the following free AARP publications, write to AARP Fulfillment, 1909 K St. N.W., Dept. GP, Washington, D.C. 20049

Stock No.	Title	Description
D1195	*More Health for Your Dollar*	Guide to health maintenance organizations (HMOs): how they work with Medicare, and the advantages and disadvantages of joining.
D12444	*Choosing an HMO*	Checklist that will help you evaluate if joining an HMO is the right decision for you.
D12403	*Working Options*	Brochure that helps plan your job search and working options.
D12380	*Money Matters®*	File folder giving advice on how to select and talk to lawyers, financial planners, tax preparers and real estate brokers.
C152	*Purchase Privilege Program*	List of service providers and member discounts.
D12386	*ADEA Guidebook*	Provides useful answers most often asked about the Age Discrimination in Employment Act.
LC38	*Information on Medicare and Health Insurance for Older People*	Provides basic information about the Medicare program and health insurance options for older persons.

The World's Most Loved Waltzes

Beloved Arthur Fiedler And The Boston Pops

Two Hearts In Three Quarter Time
Sleeping Beauty Waltz
Tales From The Vienna Woods
Gold And Silver Waltz
Swan Lake Waltz
The Blue Danube
Waltz Of The Flowers
Our Waltz
Moon River
It's A Grand Night For Singing
Tennessee Waltz
Serenade For Strings
The Skaters' Waltz
Roses From The South
Till We Meet Again
Let Me Call You Sweetheart
My Wild Irish Rose
In The Shade Of The Old Apple Tree
Moulin Rouge
Falling In Love With Love
Oh What A Beautiful Morning
After The Ball
And The Band Played On
The Last Waltz
[illegible]

The moment you start listening to these gloriously beautiful waltzes you will be swept away to a magically beautiful world of romance. Because here is all the majestic beauty of Arthur Fiedler's famous Boston Pops Symphony performing 32 of the most loved waltzes of all time. You get 32 famous waltzes from the days of old Vienna right down to the favorites of today including 3 beautiful Arthur Fiedler waltz medleys. All 32 waltzes are yours in one remarkable 2 treasury set. We unconditionally guarantee you'll love these beautiful records and tapes. Mail no-risk coupon today.

Suffolk Marketing, Inc., Dept. BP-4
475 Fifth Avenue
New York, N.Y. 10017
Please rush me the 2 beautiful Arthur Fiedler Waltz treasuries on your unconditional money-back guarantee.
☐ I enclose $12.98. Send BOTH Records.
☐ I enclose $12.98. Send BOTH Cassettes.
☐ I enclose $12.98. Send BOTH 8-Track Tapes.
No postage or handling. We pay all charges.
Name ____________
Address ____________
City ____________
State ______ Zip ______

Example #3

For years, Sullivan Publications, a for profit, tax paying business has engaged in the sales of advertising space in publications sponsored by various non-profit organizations. Sullivans' Company would sell advertising in buyers guides, membership directories, industrial guides and tour attraction historical maps under contract with the sponsoring organization. He would furnish the agreed upon copies to the sponsor at no charge.. Mr. Sullivans profit was on the sales of advertising. Recently, new situations have been created, where the Chambers of Commerce are entering the publication business and they have discontinued their contract with the publishing companies.

These non-profits are taking advantage of Sullivans' business expertise and the net result is loss of revenue, tax dollars and jobs.

letter of evidence attached C-1

[illegible]
C1

sullivan publications inc.

28 May 1987

To Whom It May Concern:

Sullivan Publications publishes Buyers Guides, Membership Directories, Maps, Industrial Guides/Directories, etc. for Chambers of Commerce, Civic Associations, Redevelopment Agencies, and Departments of Development throughout the country. These publications are supported by advertising sales and are provided at no cost to the appropriate participating organizations.

Our firm provides a complete publication service including sales, editorial, photography, typesetting, printing, bindery, and delivery.

Recently we have encountered situations where Chambers of Commerce are entering the publication business by selling advertising and publishing their maps, pictorials, and directories in direct competition with member firms and publishing companies such as ours. Since a Chamber of Commerce is chartered as a nonprofit, tax exempt organization to promote business opportunities for members and their community, we believe they violate their charter when they become a profit making business in competition with commercial non-exempt businesses.

In many areas other tax exempt organizations are also engaged in advertising sales/publishing ventures traditionally served by commercial tax paying enterprises in direct competition with my firm and similar companies.

By allowing these tax exempt organizations to enter into these business activities with the obvious advantages a tax paying business cannot compete with, it constitutes unfair competition, which if allowed to continue, will ultimately force us out of business.

The net result will be a considerable loss of revenue to my firm and others like mine, therefore resulting in a loss of jobs and a substantial loss of tax revenues.

I feel it is absolutely essential that legislation be enacted or the existing codes be modified to prohibit tax exempt organizations from engaging in business activities which are in direct competition with private enterprise.

Sincerely,

D. H. Sullivan
Publisher

2904 RUBIDOUX BLVD. ■ RIVERSIDE, CALIF. 92509 ■ PHONE (714) 686-3333

Example #4

The Santa Barbara Humane Society, has exceeded the bounds of providing shelter and treatment for stray and abandoned animals. In this affluent community, a well endowed Humane Society has opened a very large and state-of-the-art boarding kennel, offering fee for services directly to the public.

In Santa Ynez Valley, another very affluent community in California, veterinary personnel from the local Humane Society have expanded their range of services to such non-life threatening veterinary services as removal of foxtails, routine laboratory work, and making house calls to the many local ranchers. These fee for services are an expansion into for-profit business that up until now has been performed by the community veterinarian.

Evidence attached from California Veterinary Medical Association

D1 + 2

D1

CALIFORNIA
VETERINARY
MEDICAL
ASSOCIATION

JERI A. SEMER, CAE
Executive Director

June 22, 1987

Alice Gallagher Reed
91 Jackson Street
Hayward, California 94544

Dear Alice,

Pursuant to our recent conversation, I have gathered the following information regarding specific examples of what we perceive to be the abuse of tax-exempt status by nonprofit organizations.

The Santa Barbara Humane Society, (located in Santa Barbara, California,) has exceeded the bounds of providing shelter and treatment for stray and abandoned animals. In this affluent community, a well-endowed humane society has opened a very large and state-of-the-art boarding kennel, offering services directly to the public.

In the Santa Ynez Valley, another very affluent community in California, veterinary personnel from the Santa Ynez Valley Humane Society not only provide emergency surgery, spaying, neutering and vaccinations to the public, all of which are fairly traditional activities for an agency of this kind. They have expanded their range of services to such non-life threatening veterinary services as removal of foxtails, routine laboratory work, and making house calls to the many ranches in the area, caring for entire groups of dogs, cats and other animals at the ranches.

We do not dispute the vital role that humane societies play in caring for unwanted an abandoned animals, responding to public health needs through giving vaccinations or addressing the serious problem of dog and cat overpopulation by offering spays and neuters. However, the above-noted expansions into traditional forms of veterinary care, and even into the boarding of animals for profit, exceeds their charitable purposes. In fact, these activities are designed strictly to generate income, and this income should be taxed accordingly.

Continued/...

5231 MADISON AVE.
SACRAMENTO, CA 95841
(916) 344-4985

Alice Gallagher Reed
June 22, 1987
Page Two

D2

I hope that this information is helpful to you as you prepare for the hearings on June 29. Please feel free to call me at your convenience, if I may provide additional information.

Sincerely,

Jeri

Jeri A. Semer, CAE
Executive Director

JAS/dlb

cc: Board of Governors

Example #5

A non-profit Community Music Center in San Francisco, with an annual budget of $500,000 receives $50,000 from the local United Way Agency, and continues to actively solicit and receive additional funds from both the public and private sectors.

The published materials available to the public with application forms proclaim that the centers purpose is to provide "a music lesson" to people of all ages and backgrounds. The booklets state that the "only requirement is that the student is interested in learning". In reality, the center charges the music students for the lessons at the center and in a number of instances the tuition exceeds $20.00 per Hour.

Despite their inducements that "the only entrance requirement is the students interest in learning", they make clear that "students will be dropped by the office and lessons will not be given if the tuition is not paid."

Evidence attached E1 + 2

Page 6

E1

COMMUNITY MUSIC CENTER

PURPOSE
To provide high quality, accessible, and diverse music instruction and public performances that will enrich the lives of San Franciscans of all ages and backgrounds. Community Music Center is committed to making music available to everyone.

HISTORY
Founded in 1921 on Capp Street in San Francisco, Community Music Center is a private non-profit institution, and is a part of a long and proud settlement house tradition in America. Distinguished alumni of the San Francisco Community Music Center include Metropolitan Opera soprano Lucine Amara and popular singer Johnny Mathis.

In July 1983 the Center expanded its services by opening a branch facility at the Richmond District Neighborhood Center. As at the Capp Street facility, the Richmond District Branch offers private instruction and group classes for children and adults. Children between the ages of 2 and 7 can participate in classes in which they are introduced to music through movement, games and song. The Center's Chinese Music Workshop offers group instruction on traditional instruments. Both facilities are fully wheelchair accessible in keeping with the Center's goals.

Each year the San Francisco Community Music Center provides training in music for over 2,000 students of all ages and levels of ability. The only entrance requirement is the desire to learn. The faculty of professional musicians is responsive to the needs of the individual students.

COST
Fees are on a sliding scale based on family income. The one-half hour private lesson ranges in cost from $42-$120/Quarter (twelve weeks), $28-$84/Summer (eight weeks) for children and $66-$120/Quarter, $44-$84/Summer for adults. Seniors (age 62 and up) pay a flat fee of $60/Quarter, $42/Summer.

INSTRUCTION
San Francisco Community Music Center offers a flexible curriculum for students with a wide range of abilities. Offerings include:

- Private Lessons (Various Traditions)
- Music for Children
- Chinese Music Workshop
- Chamber Music Coaching
- Popular Voice
- Garage Band Workshop
- Music Theory
- Reading and Writing Music
- Ear Training and Sightsinging
- Jazz Workshop
- Performing Opera Workshop
- S.F. Children's Chorus

FOR FREE CATALOG CALL

647-6015
544 Capp Street
Mission District

221-4515
741 30th Avenue
Richmond District

SAN FRANCISCO
COMMUNITY
M·U·S·I·C
CENTER
FOUNDED 1921

SAN FRANCISCO
COMMUNITY
M·U·S·I·C
CENTER

MEMBERS RECEIVE:

Recognition in DoReMi, Community Music Center's quarterly newsletter.

New members at $50 or renewals at $100 will receive a free CMC T-shirt or tote bag. Specify choice. T-shirts: Indicate size/men, women, children.

Advance notice of all CMC concerts.

Complimentary tickets good at the Community Music Center concert of your choice.

Invitations to special donor events.

The satisfaction of supporting an essential part of our community's cultural life.

SPONSORS RECEIVE:

A free performance by a faculty ensemble at your home or workplace.

Enclosed is my gift of:
- ☐ $1,000 Sponsor
- ☐ $500 Angel
- ☐ $250 Benefactor
- ☐ $100 Patron
- ☐ $50 Friend
- ☐ $25 Associate
- ☐ $ ____ Other

Signature ______________________

Date ______________________

Name(s) ______________________

Address ______________________

City ______________________

State ______________ Zip ________

Optional: Please use this gift for ______________________

Please made check payable to COMMUNITY MUSIC CENTER .

All gifts are tax-deductible.

And finally, Mr Chairman,

Some of the abuses are long-standing, but some are new. Just a few years ago, a non-profit Corporation was established for the construction and operation of a new aquarium in Monterey. The operation opened with much public acclaim, but to the consternation of the restaurants, which are its neighbors on Cannery Row, the aquarium is advertising to the public that they can (and are) providing the rental of their facility to the general public. This service is complete with food service, catering for banquets, a souveneir/sundry shop and special convention packages. As a result of this new unfair competition, a number of otherwise successful restaurants and businesses have been forced to closed their doors. The remaining business owners have joined together to seek a way to maintain their investments and to attract the large numbers of clientele they have served for years and at the same time provide tax dollars for the support of local, state and federal government.

business owner contacts;

Dick O'Cane	408-375-1921
John Pisto	408-373-3778
Derek Cockshut	408-646-1142

Example #7

One thousand tax-paying businesses compete with their own tax dollars because not-for-profit hospitals, universities and clinics sell hearing services to the general public with no regard to health or financial need.

The hospitals, universities, government facilities and clinics, having realized the donation of expensive equipment, products, staff, and money for "research" and "public education", do not have enough research to maintain the facilities. The not-for-profits have gone elsewhere to fund their hearing service businesses.

The tax exempt abuses of these not-for-profit Corporations includes;
1. Manufacturers' donation of expensive modern computerized test equipment (i.e. audiometers, Impedence Bridges, hearing aid Analyzer test equipment, Sound Field Verification Meters, Sound Level Meters, Repair Tools, BSR/MIR Computers, probe systems, and word processing general office computers.
2. Non-profit Corporations have much or all of the office furnishing donated or given to them.
3. The staff is usually already present and minimal new staff is added. There is minimal rent, no property tax and practically no income tax.

4. The billing process including Medicare/MediCal is usually in place and does not require additional staff for processing.
5. Access to existing patient giles and exclusive mailing lists at a reduced postal rate .
6. Becuase of the access to medical doctors on staff at hospital or clinic Medicare can be billed for services that a retail hearing service office can NOT bill for---even if a medical doctor is on staff.
7. Universities guise their commerical hearing services business as part of the "educational process", yet unlicensed, untrained students practice on the hearing impaired to gain a degree and a grade.
a commercial hearing aid business, must be open to the general public at reqular business hours, maintain hours of continuing education, offer a 30 day assistive device warrantyies, and maintain excellent business practices while the not-for-profit entity must not comply with any business practices. Many of the not-for profit hearing service organizations sell USED HEARING AIDS to the general public at a profit and disguise this practice as a loaner program or "hearing aid bank".

F14 + 1
F16 +

evidence F1-F23 page 8

The not-for-profit organizations, who engage in a for-profit retail sales of hearing aids, services and repairs include;

United Way Funded Agencys
Easter Selas
Community Hospitals of Central California
Providence Speech and Hearing
Valley Hospital Medical Center
University of California at Los Angeles Medical Center
University of California at San Francisco Medical Center
California State University at Northridge
California State University at Los Angeles
California State University at Davis
California State Unversity at Sacramento
Saint Johns Hospital and Health Center at Santa Monica
Daniel Freeman Memorial Hospital at Inglewood
Simi Valley Adventist Hospital
Stanford Medical Center
Hearing and Speech Society of Stanislaus County
San Francisco Speech and Hearing Center
Hearing Society of the Bay Area
Kaiser Foundation Hospitals
Ear House Institute
Marin County Hearing and Speech Center -Marin General Hospital
Herrick Hospital at Berkeley
Alta Bates Hospital at Berkeley

More could be supplied upon request..

evidence attached F1-23

F1

HEARING AID ASSOCIATION OF CALIFORNIA
District #6
5363 Wilshire Blvd. • Los Angeles, CA 90036 • Telephone: (213) 938-2029

President
MARVIN BERKE
(213) 938-2029

Vice President
PAT WINSLOW
(213) 583-6438

Vice President
ROSE CALANDRA
(213) 393-0511

Secretary
SALLYE CARPENTIER
(213) 433-6701

Treasurer
DON PEARLMAN
(213) 373-8753

Board of Directors
KEN BAIRD
(818) 842-4069

JOAN M. GAGNE
(213) 373-3555

BEN HERLEIN
(805) 965-6988

MICHELE J. IKUTA
(213) 276-3432

BOB KOCH
(213) 373-8753

RON MAGNUSSON
(805) 654-8551

KEN REVIE
(818) 246-4839

BRITT RIVERS
(213) 862-9629

MAY 27, 1987

DEAR ALICE,

AS PER OUR TELEPHONE CONVERSATION OF YESTERDAY, I AM ATTACHING A LIST OF FACILITIES SUCH AS HOSPITALS, UNIVERSITIES, ETC. THAT ARE DISPENSING HEARING AIDS IN DIRECT COMPETITION WITH THE PRIVATE SECTOR (SMALL BUSINESSMEN LIKE ME AND OTHER MEMBERS OF THE HEARING AID ASSOCIATION). EVEN THOUGH THESE "NON-PROFIT/TAX EXEMPT" INSTITUTIONS HAVE BEEN ADVISED THAT DISPENSING HEARING AIDS FOR PROFIT, WAS ILLEGAL (UCLA WAS ADVISED, IN THE PAST, TO CEASE, BY SENATOR HERSCHEL ROSENTHAL) THEY CONTINUE TO DO SO.

THE UNIVERSITIES RATIONALIZE THAT DISPENSING HEARING AIDS IS A NECESSARY PART OF THE CURRICULUM OF THEIR AUDIOLOGY PROGRAM. OTHER FACILITIES ARE ONLY CONCERNED WITH THE PROFIT TO BE MADE.

I AM SURE THE ATTACHED LIST IS ONLY THE TIP OF THE ICEBERG. MY COLLEAGUES FEEL FRUSTRATED THAT NOTHING WILL BE DONE TO STOP THIS PRACTISE, THAT THEY HAVEN'T BOTHERED TO GIVE ME THE NAMES OF OTHER INSTITUTIONS.

WE CAN ONLY HOPE THAT THE SBA IS SUCCESSFUL IN THEIR EFFORT TO GET LEGISLATION PASSED TO STOP THIS UNFAIR COMPETITION.

SINCERELY YOURS,

Marvin Berke

MARVIN BERKE

F2

Fresno Bee
Metro 9/10/86
B6+8

Wed. Sept. 10

On this date in 1955, "Gunsmoke" made its premiere on CBS television.

HAPPY BIRTHDAY — Actress Fay Wray is 79. Movie director Robert Wise is 72. Golfer Arnold Palmer is 57. CBS news correspondent Charles Kuralt is 52. Actor Greg Mullavey is 47. Singer Jose Feliciano is 41. Actress Judy Geeson is 38. Margaret Kemper (formerly Margaret Trudeau) is 38. Actress Amy Irving is 33.

The big event

Ringling Bros. and Barnum & Bailey Circus opens with a show at 7:30 tonight at the Fresno Convention Center, 700 M St. Tickets, normally costing $6.50, $8 and $9, are discounted by $2 for this family night. Tickets are available at the Convention Center box office, BASS ticket outlets or by calling 233-4571. For details, call 233-8368.

Odd lots

A jeweled French champagne bottle worth an estimated $100,000 is being displayed this year at restaurants, wine retailers and wine-tasting events around the United States.

Based on a design created 100 years ago by the Russian goldsmith Faberge, the bottle is adorned with gold rings and inlays of lapis lazuli and other brilliant stones. The design was commissioned by Piper-Heidsieck.

After its tour, the bottle will be returned to a vault in Reims, France.

— Associated Press

Trivia

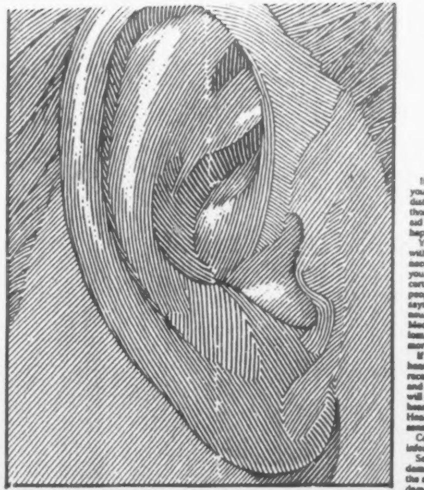
Rock star Billy Preston's mother played Sapphire in the "Amos 'n' Andy" TV series.

— The Book of Strange Facts & Useless Information, Doubleday, $7.95

The mouths

Hear it all with little aid

By FRANCESCA LUNZER
Forbes magazine



Thorne Corse, 65, is a litigation lawyer in California. A couple years ago he finished a day in court straining to hear the judge, whose bench was a fair distance away.

As he was leaving, his partner let him know that it had been obvious that Corse couldn't make out everything the judge had said.

"After that," says Corse, who now wears a hearing device, "it was either get help or stop pleading cases in big courtrooms."

Corse is hardly alone. Many people in middle age who suffer hearing loss shun devices.

In fact, according to the Hearing Industries Association (HIA), 11 percent of people 45 to 64 have impaired hearing severe enough to warrant a hearing aid. Yet only 2 percent of those in that age bracket wear them.

Hearing loss during middle age is sometimes related to infection, injury or exposure to noise. But often it's the start of a progressive hearing loss that is normal for about half the population over 65.

People who have mild to moderate losses are the ideal candidates for hearing aids. But often they are reluctant to wear them for fear of looking old or significantly impaired. Or they are simply unaware of how helpful a hearing aid can be.

So they tune out or simply miss out.

More specifically, the 12 million people with mild to moderate hearing loss have trouble hearing sounds measured at 25 to 55 decibels. (A whisper measures about 30 decibels, while loud conversation reaches about 55 decibels.)

A hearing aid amplifies the physical energy that enters the ear and is decoded by the brain as sound. An aid raises the decibel level to a point that the ear can perceive and transmit to the brain.

Advances in circuitry and electronics in the past few years have allowed manufacturers to produce smaller and less conspicuous hearing aids. Those developments encouraged many, including President Ronald Reagan, to come out of the closet about their hearing problems.

The in-the-ear type of device the president wears quickly became the style-setter. Less noticeable than the traditional behind-the-ear aid, it now accounts for 64 percent of all hearing aids sold, up from 31 percent in 1980.

Although sales are expected to double between 1983 and 1988, the HIA estimates that only 17 percent of people of all ages who need hearing aids are wearing them at the moment.

Is there any advantage to waiting until your hearing loss is severe before getting a hearing aid? Just the opposite, says Dr. J. William Wright Jr. of the American Academy of Otolaryngology.

A person who begins wearing a hearing aid while his loss is not too severe will find it easier to get accustomed to the somewhat changed sound that a hearing aid produces, which is much like hearing your voice on tape.

Also, a hearing aid will help you to recapture certain words that have probably become less and less distinct as your hearing has deteriorated. The higher-frequency sounds are the first to fade, including consonants like s, f, and sh.

"It's like reading a newspaper and having those letters go out," says Sharon Fujikawa, an audiologist and associate professor at the University of California at Irvine.

If the impairment becomes more severe, your distorted hearing could result in distorted pronunciation. Being able to hear those sounds clearly with the help of an aid will diminish the likelihood of that happening.

Yet another reason for learning to live with an aid before it is absolutely necessary is to avoid making a nuisance of yourself. Wearing a hearing aid is certainly preferable to constantly asking people to speak up or repeat themselves, says Dr. J.J. Wazen, director of neurotology at Columbia-Presbyterian Medical Center in New York. "A hearing loss," he says, echoing a popular ad, "is more noticeable than a hearing aid."

If you have noticed a change in your hearing ability, ask your physician to recommend a otolaryngologist (ear, nose and throat doctor). The otolaryngologist will test you to determine if you have a hearing loss and what the cause is. Hearing losses are usually conductive or sensorineural.

Conductive losses can be caused by infection, injury or even wax buildup.

Sensorineural hearing loss is caused by damage to the cochlea (the inner ear) or the auditory nerve. When the cochlea is damaged, sound can be amplified but the brain receives incomplete signals, so what is heard is somewhat distorted.

Whatever the cause of your hearing loss, if your doctor thinks a hearing aid is in order, he'll suggest you be tested by an audiologist or a hearing aid specialist. Your hearing aid will then be designed so that the amplification it provides makes up for your impairment.

Traditionally, all a hearing aid could do was amplify sound to the cochlea for transmission to the brain. But aids are getting better all the time. Recently, manufacturers have introduced automatic gain control, which reduces the volume of all sound once it gets too loud. "That keeps you from having your ear blasted out when amplified sound reaches a level you could hear on your own," says Dr. Aram Glorig, senior advisor to the hearing aid project at the House Ear Institute in Los Angeles.

Another innovation to be released this spring is an in-the-ear hearing aid with

[illegible]

Hearing

Continued from Page B6

automatic signal processing. "As situations like riding in a car or being at a party get noisier," says James Kates, director of basic research at Siemens Hearing Instruments, Inc., "the hearing aid would give you amplification only of sounds at higher frequencies. That's the energy region most important for understanding speech."

Conventional aids cost close to $700, and those with signal processing will run about $150 more. Unfortunately, unless your hearing loss is work related, very few insurance plans cover the cost of testing or the device itself.

Dr. Glorig hopes that within five years hearing aids will be able to cut out certain frequencies so that only the missing sounds are amplified.

But there is progress at the other end of the spectrum, too — totally devoid of electronics. One company, Innovative Hearing Corp., is marketing a hearing device for the mild to moderately hearing-impaired that is simply a smaller version of the old-fashioned ear trumpet.

Called the Innovaid, the device is a small, round "sound collector" that fits right in the ear. By changing the size and shape of a small hole in the center of the Innovaid, the device increases the amplification of sound to the outer ear by about 15 decibels — much like cupping your hand to your ear.

This device is useful for people who need a bit of assistance, but it won't be of use if your hearing loss is above 45 decibels. At about $240, the Innovaid is less than half the cost of a battery-powered aid, but you'll still need audiologic testing. And you may still need a conventional aid if your hearing impairment worsens.

While there's no question that there is still some stigma attached to wearing an aid, the improved hearing and comprehension that an aid can provide are usually well worth that price. Donald Kendall, chairman of PepsiCo, has been wearing an aid for two years.

"I wish I had worn it for the last five or six," says Kendall, who suffered hearing loss while a Navy pilot in World War II. "Now I can hear the nasty comments my 17-year-old son makes about me."

© 1986 Forbes Inc.

Community Hospitals of Central California (CHCC) will present a class on "Hearing Loss and the Senior Citizen," from 9 to 11 a.m. Sept. 24 at the CHCC Home Services Department, 4120 N. First St. Fee is $5 per person. For details and reservations, call 442-6433.

Woody

Continued from Page B6

That would still leave me $4 for lunch.

He ignored the offer as he filled the replacement tire with air. But as soon as he got it filled, it began to hiss back at him, too.

He kicked it two or three times, removed it, went to the back of the van and got out yet another emergency spare.

He caught me reading the truck again and backed up against the printing: "I told you not to read my truck," he said.

Obviously, my offer of a $3 interview had been rejected.

"OK," I said. "You win. I'll pay

FABRIC
SALE
WED.
SEPT. 10TH
THRU
SUN.
SEPT. 14TH

F4

Providing
Quality Care
for More
Productive
Lives

PHYSICAL THERAPY

SUPPORT AND EDUCATION GROUP

THERAPEUTIC POOL THERAPY

Fees for service

The Easter Seal Society of Alameda County accepts private payment and also bills Medicare, Medi-Cal and most insurance companies. A Sliding Fee Payment Plan based on financial need is available to Alameda County residents. Scholarships for service are also available.

Eligibility for services

Who is eligible? You are! We have no restrictions as to age, sex, economic status, race, color, religion or national origin. There are no geographical limitations for those who require services at our Rehabilitation Center. Home therapy services are available only to residents of Alameda County.

Call us now at (415) 835-3962.

The Easter Seal Society of Alameda County
2757 Telegraph Avenue
Oakland, CA 94612

HOW TO FIND US
Easter Seal Rehabilitation Center
Lake Merritt

Easter Seal Society
Rehabilitation
Center OF ALAMEDA COUNTY

Providing
Quality Care
for More
Productive
Lives

Easter Seal Society
Rehabilitation
Center OF ALAMEDA COUNTY

The Easter Seal Society of Alameda County
2757 Telegraph Avenue
Oakland, CA 94612
(415) 835-2131

Since 1938, the Easter Seal Society of Alameda County has provided rehabilitation services to the disabled people of our community. Today, the Easter Seal is a symbol of quality care for all ages.

The Easter Seal Rehabilitation Center in Oakland is a free-standing out-patient facility offering multi-services that can be provided in "one-stop" visits. This capability saves clients a series of time-consuming appointments in different locations. The Center is a licensed Rehabilitation Agency, is accredited by the Commission on Accreditation of Rehabilitation Facilities, and is an affiliate of the State and National Easter Seal Societies.

The multi-service approach greatly enhances coordination of different treatments, with Client Care Conferences an integral part of each person's program. Individualized programming underscores the Easter Seals Pledge:

Providing
Quality Care
for More
Productive
Lives

F5

How to use the services of the Easter Seal Society

Clients
Great emphasis is placed on the treatment of clients as individuals. Your concerns are our concerns. Our goal is to help you lead a more productive life.

Physicians
A written prescription and medical history are required for services to be provided. You are encouraged to actively participate in your clients' rehabilitation programs.

Agencies
The Easter Seal Society is committed to effecting the continuum of health care in concert with other service providers. Our professional staff can provide initial rehabilitation services to your clients and/or continue your treatment plans when outpatient care is indicated.

Insurance Companies
The Easter Seal Society actively solicits your business. We will tailor our program to your needs. Our professional staff is aware of your requirements for quality care and cost control.

Out-patient Treatment-Plus

Services include:

- Physical Therapy
- Occupational Therapy
- Speech/Language Therapy
- Social Services/Counseling
- Support Groups
- Education regarding disability
- Referral to community resources
- Professional and community education and consultation

Our therapists treat clients in our Center as well as hospitals, nursing homes, schools and in their own homes.

Who can use our services

Pre-schoolers to senior citizens can use our services. Our agency treats predominantly neurological and orthopedic diagnoses, including disabilities related to stroke, spinal cord/head injury, arthritis and amputation, as well as developmental problems. We also treat social and emotional problems related to physical disability.

The Easter Seal "team approach" to client care

The team approach by our experienced staff provides evaluation, planning and treatment to promote health, health maintenance and independence.

Rehabilitation Medicine
- Evaluation and consultation by a physiatrist

Physical Therapy
- Neuro-muscular re-education
- Gait training
- Therapeutic pool exercise program
- Ultrasound, electrical stimulation
- Whirlpool and massage
- Traction
- Contrast baths
- Jobst pump

Occupational Therapy
- Neuro-muscular re-education
- Training in activities of daily living
- Adaptive devices and splints
- Neuro-developmental training
- Energy conservation and work simplification

Speech and Language Therapy
- Listening, speaking, gesturing training
- Reading and writing training
- Family education
- Training for use of augmentative devices for individuals and groups
- Computer Program

Social Services
- Psychotherapy and counseling
- Peer support groups
- Family treatment
- Amputee visitation program
- Information and referral

Psychological and neuro-psychological services, audiological services, and recreational opportunities such as our Summer Camp Program, are also available.

Providing Quality Care for More Productive Lives

SPEECH THERAPY

OCCUPATIONAL THERAPY

ADAPTIVE EQUIPMENT THERAPY

Working together for quality care

Our professional associates include:

- American Cancer Society
- American Heart Association
- Arthritis Foundation of Northern California
- Ashby Geriatric Hospital
- California Association of Adult Day Services
- Community Adult Day Health Services
- Claremont Convalescent Hospital
- Dowling Convalescent Hospital
- Kaiser Foundation Hospitals
- Kyakameena Skilled Nursing Facility
- Merritt-Peralta Hospitals
- Multiple Sclerosis Society
- Oakland Headstart Program
- Providence Hospital
- University of California, San Francisco School of Medicine
- Vista College

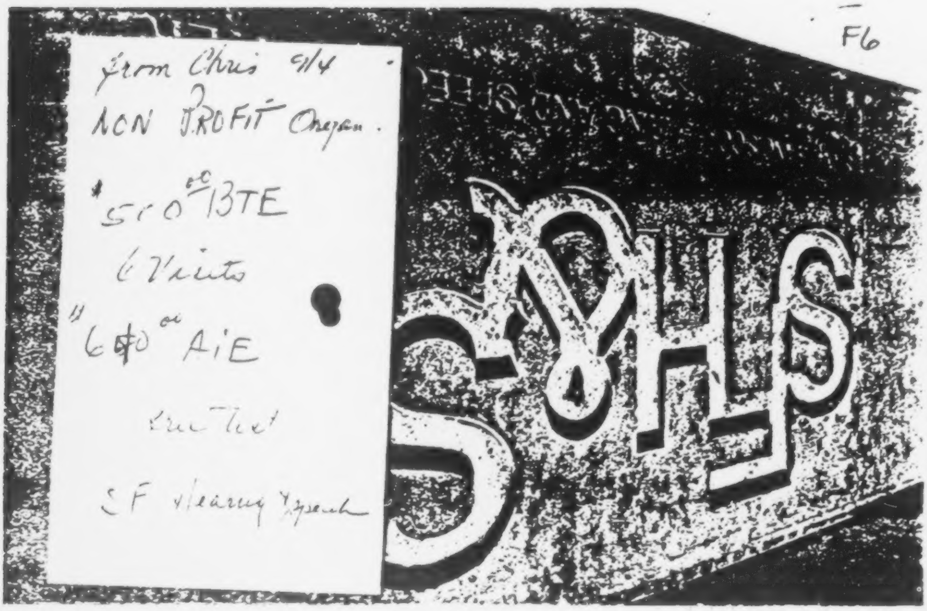
Medical and professional advisory committees

Serving on an annual basis, advisory committees composed of physicians and other medical professionals work closely with our staff to evaluate current programs and recommend changes. We invite your involvement and advice for our program-planning.

Community leaders

Community and civic leaders serve voluntarily on our active Board of Directors.

F6



from Chris 9/4
NON PROFIT Organ.
$500.00 BTE
6 Visits
$640.00 AIE
Free Test
SF Hearing & Speech

Appointment Procedures:

Children and adults with hearing, speech or language disorders are accepted for services, regardless of age, race, religion or national origin. ~~Referral to the Center is through any licensed physician or medical agency; forms are available upon request.~~ Appointments are necessary. All staff members are appropriately credentialed and/or licensed.

Hours: The Center is open Monday through Friday, 9 AM to 5 PM. Language classes for children operate from 9 AM to 3 PM weekdays during the school year.

Fees: Costs for services are determined by bi-annual time/cost studies. Fees vary according to services rendered, in all cases set at actual cost. Schedules are available upon request. Consideration of fee adjustment is made when a financial hardship is present, with no one refused services because of inability to pay.

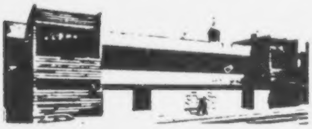
Location: The Wattis Building, home of the San Francisco Hearing and Speech Center, is located at 1234 Divisadero Street, San Francisco 94115. Telephone (415) 921-7658. Parking is available in the rear of the building. Buses serving the Center include the 24 Divisadero, 38 Geary, and 31 Balboa.

There is provision for parking for the handicapped and wheelchair access.

The Center is fully accredited by the Professional Services Board of the American Speech and Hearing Association.

The Center is a member agency of the United Way of the Bay Area.

El San Francisco Centro de la Audición y Lenguaje Hablado acoge con gusto personas que hablan solamente Español. Así niños, como adultos tienen que ser mandados aquí de un médico.



San Francisco Hearing and Speech Center

A non-profit community service agency dedicated to hearing, speech, or language handicapped children and adults.

F7

Audiology program:

Hearing evaluations for all ages, newborns to the aged, including diagnostic evaluation, hearing aid consultations and extensive counselling within the area of aural rehabilitation. Middle ear evaluations with impedance audiometry, medical legal testing, industrial assessments, and in-hospital testing for those unable to come to the Center are also available. Physical evaluations of hearing aids are conducted with electro-acoustic instrumentation.

Speech Pathology program:

Speech, language, and voice evaluations are conducted for both children and adults, followed by individual or group therapy. Types of problems include: delayed speech and language, sound articulation and clarity disorders, voice problems, stuttering, foreign accent, adult communication problems secondary to brain damage, and cleft palate. Evaluation and treatment are provided for children who are found to have a language-based learning problem or auditory processing difficulties.

Education program:

Full time classes for children with aphasia and related language disorders. Class size limited, with intensive instruction in speech, writing, language structure, and understanding spoken and written language. Diagnostic evaluation of language disorders in children with individual testing, experimental teaching, and counseling for parents.

Education for the hearing impaired and deaf with individual training and therapy. Special groups or classes are formed when there are sufficient numbers of children identified, including those at the preschool age.

Research program:

Applied clinical research in all programs: audiology, speech pathology, and education. Special projects and studies are supported by contributions, both private and public agency grants.

Scholarships

The following students earned scholarships and awards at C.M. Russell High School

Aanrud

Adams

Jay Aanrud, son of Jim and Pat Aanrud, Rural Route 5407, U.S. Air Force Academy Appointment, $170,000, Presidential Academic Fitness Award, will attend Air Force Academy, Colorado Springs, Colo.

Scott Adams, son of Jack and Susan Adams, 538 32nd Ave. NE, Presidential Academic Fitness Award, Montana University System Honor Scholarship, $750, Fred and Marie Barnard Scholarship, $583, will attend Montana State University.

Darin Anderson, son of Lowell and Joan Anderson, 770 33A Ave. NE, Pacific Lutheran University Scholarship, $1,500, Pacific Lutheran Talent Award, $1,500, will attend Pacific Lutheran.

Lorna Armacost, daughter of Rollie and Darlene Armacost, 1217 Buena, Presidential Academic Fitness Award, Montana University System Honor Scholarship, $750, Nettie Kirwin Award, $100, will attend MSU.

Suzanne Axtman, daughter of Raymond and Adeline Axtman, 712 demic Fitness Award, Nettie Kirwin Award, $100, will attend Great Falls Vo-Tech Center.

Rebecca Bates, daughter of Gerald Bates, 1108 Adobe, Boston University Trustee Scholarship, $11,000 per year, St. Catherine of Alexander Scholarship, $1,000, Sophia Brough Kampfer Scholarship, $5,400, Presidential Academic Fitness Award, Treacy Giesler Memorial Scholarship, $300, will attend Boston University.

Anderson

Bates

Katie Benson, daughter of Jordan and Judy Benson, Rural Route 1084, Montana Lumberman Association Scholarship, $250, will attend MSU.

John Blades, son of Marlyn Blades, 234 Smelter Ave. NW, Pacific Challenge Award, $2,500, will attend Pacific University.

Glenn Bliss, son of Glenn F. and Dianna Bliss, 1128 Valleyview Drive, Carroll College Basketball Scholarship, $6,000, Presidential Academic Fitness Award, will attend Carroll College.

Blades

Bliss

Michele Buresh, daughter of Ed and Carol Buresh, 515 28th Ave. NE, Presidential Academic Fitness Award, Idaho State University Track and Field Scholarship, $3,800, University of Montana Track and Cross Country Scholarship, $725, MSU Track and Cross Country, $2,500, college undecided.

Buresh

Donohue

Cheryl Burleigh, daughter of Pete and Kelly Burleigh, 812 Grizzly Drive, Presidential Academic Fitness Award, MS University Honors Music Scholarship, $900, University of Portland Honors at Entrance Award, will attend MSU.

Richard Burnett, son of Dayle and Pat Burnett, 24 19th Ave. S., MSU College of Letters and Sciences Christy Foundation, $300, will attend MSU.

Kyle Critchfield, son of Lewis and Margie Critchfield, 2720 Evergreen Drive, Presidential Academic Fitness Award, MSU A.J.M. Johnson, Department of Physics, $800, will attend MSU.

Duffy

Fairchild

Doug Dockter, son of Duane and Lois Dockter, 1804 19th Ave. NW, Presidential Academic Fitness Award, will attend MSU.

Amy Donohue, daughter of Ed and Carol Donohue, 108 17th Ave. NW, Sophia Brough Kampfer Scholarship, College of St. Catherine, $8,400, will attend College of St. Catherine.

Kathy Duffy, daughter of Kenneth and Jean Duffy, 704 34th Ave. NE, MSU Chemical Engineering Scholarship, $1,200, Presidential Academic Fitness Award, Montana University System Honor Scholarship, $750, MSU Julie Martin Estate, $800, will attend MSU.

Sean Fairchild, son of Garry and Trudi Guidotti, Rural Route 1205, Presidential Academic Fitness Award, Montana University System Honor Scholarship, $750, Fred and Marie Barnard Scholarship, $583, will attend MSU.

Carl Fehres, son of Hans and Pauline Fehres, 1128 Ave. D NW, Officers' Wives' Club, $1,000, MSU Music Scholarship, $800, will attend MSU.

Teresa Feldman, daughter of Frank and Eileen Feldman, 1308 3rd West Hill Drive, Presidential Academic Fitness Award, Marge Engren Memorial Scholarship, $300, will attend MSU.

Tiffany Giesler, daughter of John and Sheila Giesler, 1116 Adobe Drive, Carroll College Freshman Honor Scholarship, $2,400, Presidential Academic Fitness Award, St. Mary's of the Plains College, Kan., $4,400, will attend Carroll College.

Continued on page 6.

Kids Fashions
NOW IN! TODDLER OSHKOSH AND SUSPENDERS
FOR BOYS & GIRLS
• DRESSES 15% OFF • SHORTS & SHORT SETS 10% OFF
• SPRING & SUMMER JACKETS 20% OFF
(OPEN MEMORIAL DAY)
WESTGATE SHOPPING MALL 453-5437
STORE HOURS: WEDNESDAY 10:30 AM-9 PM, THUR.-SAT. 10 AM-6 PM

BODY IMAGES/
AEROBIC FITNESS
FORMERLY
MONTANA AEROBIC DANCE
JAN WALER, Owner 727-8866

KIDERCISE
Fun Fitness For Kids
Ages 3-6, 7-10
6-Week Sessions
2nd Session, Sat., May 31 - 10:15 a.m.-11:15 a.m.
• Coordination Skills (hand, eye, etc.)
• Rhythm • Balance • Individual and group activities • Aerobic dance and exercise • Fun!

NEW CLASSES

CO-ED CIRCUIT TRAINING
SATURDAYS at 9:00 a.m.
Rotating exercise stations including:
• French press • Bicep curls
• Jump rope • Abdominal exercises
• Aerobic Workout / cardiol vascular
AND OTHERS
Great for the husbands!

GET THE WHOLE FAMILY INTO FITNESS!

ALL CLASSES INTERCHANGEABLE TO FIT YOUR SCHEDULE

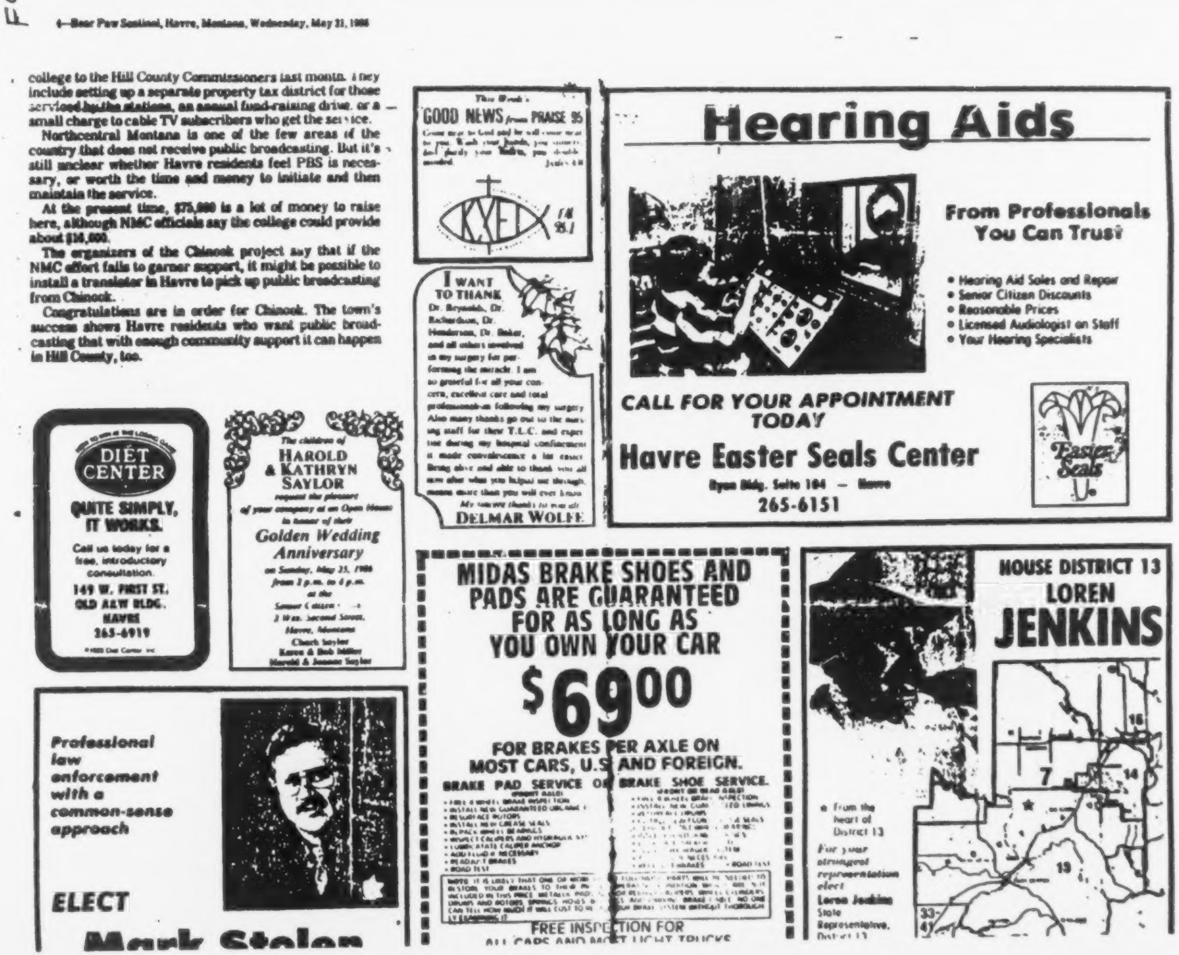
	MON.	TUES.	WED.	THURS.	FRI.	SAT.
9:00 A.M. **	Aerobics **	Light & Lively **	Aerobics **	Light & Lively **	Aerobics **	Co-Ed C.
10:15 A.M.						Kidercise
4:15 p.m. **	Aerobics **	Aerobics **	Aerobics **	Aerobics **		
5:30 p.m.	Aerobics	Aerobics	Aerobics	Aerobics		
6:30 p.m.	Aerobics	Aerobics	Aerobics	Aerobics		
*7:30 p.m.	Light & Lively		Light & Lively	Light & Lively		

*Light-n-Lively classes are for beginners. [illegible] Call for more info.
** Babysitting Available 727-8866

Classes Held At The Civic Center Ballroom

Hearing Aids
From Professionals You Can Trust
• Hearing Aid Sales and Repair
• Free Hearing Tests
• Sr. Citizen Discounts
• Reasonable Prices
• Licensed Audiologist on Staff
• Your Hearing Specialists
Great Falls Easter Seals Center
4400 Central Ave.
761-3680
Easter Seals
CALL FOR YOUR APPOINTMENT TODAY

F9



6—Bear Paw Sentinel, Havre, Montana, Wednesday, May 21, 1986

college to the Hill County Commissioners last month. They include setting up a separate property tax district for those serviced by the stations, an annual fund-raising drive, or a small charge to cable TV subscribers who get the service.

Northcentral Montana is one of the few areas of the country that does not receive public broadcasting. But it's still unclear whether Havre residents feel PBS is necessary, or worth the time and money to initiate and then maintain the service.

At the present time, $75,000 is a lot of money to raise here, although NMC officials say the college could provide about $16,000.

The organizers of the Chinook project say that if the NMC effort fails to garner support, it might be possible to install a translator in Havre to pick up public broadcasting from Chinook.

Congratulations are in order for Chinook. The town's success shows Havre residents who want public broadcasting that with enough community support it can happen in Hill County, too.

This Week's
GOOD NEWS from PRAISE 95
KYEI FM 95.1

I WANT TO THANK
Dr. Reynolds, Dr. Richardson, Dr. Henderson, Dr. Baker, and all others involved in my surgery for performing the miracle. I am so grateful for all your concern, excellent care and total professionalism following my surgery. Also many thanks go out to the nursing staff for their T.L.C. and expertise during my hospital confinement it made convalescence a lot easier. Being alive and able to thank you all now after what you helped me through means more than you will ever know.
My sincere thanks to you all
DELMAR WOLFE

Hearing Aids
From Professionals You Can Trust
- Hearing Aid Sales and Repair
- Senior Citizen Discounts
- Reasonable Prices
- Licensed Audiologist on Staff
- Your Hearing Specialists

CALL FOR YOUR APPOINTMENT TODAY
Havre Easter Seals Center
Ryan Bldg. Suite 104 — Havre
265-6151
Easter Seals

DIET CENTER
QUITE SIMPLY, IT WORKS.
Call us today for a free, introductory consultation.
149 W. FIRST ST.
OLD A&W BLDG.
HAVRE
265-6919
©1985 Diet Center Inc.

The children of
HAROLD & KATHRYN SAYLOR
request the pleasure of your company at an Open House in honor of their
Golden Wedding Anniversary
on Sunday, May 25, 1986
from 2 p.m. to 4 p.m.
at the
Senior Citizen's Center
2 West Second Street,
Havre, Montana
Chuck Saylor
Karen & Bob Miller
Harold & Joanne Saylor

MIDAS BRAKE SHOES AND PADS ARE GUARANTEED FOR AS LONG AS YOU OWN YOUR CAR
$69.00
FOR BRAKES PER AXLE ON MOST CARS, U.S. AND FOREIGN.
BRAKE PAD SERVICE OR BRAKE SHOE SERVICE.
FREE INSPECTION FOR ALL CARS AND MOST LIGHT TRUCKS

HOUSE DISTRICT 13
LOREN JENKINS
★ From the heart of District 13
For your strongest representation elect
Loren Jenkins
State Representative, District 13

Professional law enforcement with a common-sense approach
ELECT
Mark Stolen

F/D

What Will This Cost?

You can see an otologist and audiologist as a private patient, or in an out-patient ear, nose and throat clinic of a hospital. In most clinics, hospitals and centers, fees are determined by your ability to pay. If you have private health insurance or a group medical plan, you may be covered for the costs of medical and audiological care. Some public programs may offer assistance also:

Medicare

Anyone who is 65 years of age or older and a legal resident of the United States is eligible for Medicare. Part A, covering a portion of in-patient hospital costs, is provided through Social Security at no cost. Part B Medicare coverage is optional, and the cost of this coverage may be deducted from your Social Security check or paid by you through a private insurance plan. Part B covers many out-patient services, after a deductible amount for the year has been paid. If you have Medicare, Part B and if you have already paid your deductible for the year, as much as 80% of the cost of the doctor's examination and the initial audiological test may be reimbursed to you. Not all facilities providing these services, however, are eligible under Medicare regulations for you to receive reimbursement; therefore, it is advisable to check on their Medicare eligibility before making an appointment. Medicare will *not* pay for the hearing aid evaluation or selection service at any testing center, or for a hearing aid.

MedicAid
(In California, this is called MediCal)

MediCal is another form of national health assistance, based on financial need. In California, complete otological and audiological services are included, and hearing aids are paid for in full or in part for those persons meeting the state requirements for participation in the program. Check with your local MediCal office or call the Social Security office for referral to the appropriate agency in your state.

California Childrens Service

Certain California children under age 18 are eligible for financial assistance and social work services for handicapping problems. Sometimes assistance with medical and audiological evaluation, rehabilitation and hearing aids can be provided. For the proper phone number, check the phone book white pages under State of California, Health Services Department, for California Childrens Service.

Department of Rehabilitation

This state department helps people overcome barriers to employment or independent living through counseling, vocational evaluation, training, information, and assistance with specific financial needs under certain circumstances. For information, call the State of California Department of Rehabilitation.

WANTED!

WE ARE SEEKING DONATIONS OF USED HEARING AIDS.

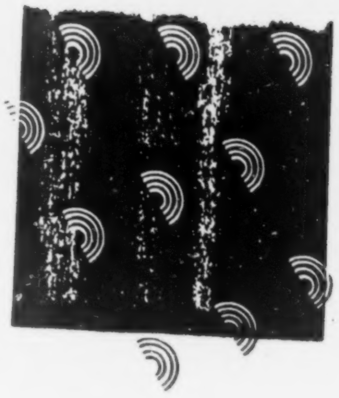
HEARING SOCIETY FOR THE BAY AREA, INC.

TELEPHONE (415) 775-5700
1428 BUSH ST. SAN FRANCISCO 94109

For additional information write or call:

HEARING SOCIETY
FOR THE BAY AREA INC.

1428 Bush Street
San Francisco, CA 94109
(415) 775-5700



If You Think You Have a Hearing Loss . . .

a publication of

HEARING SOCIETY
(FOR THE BAY AREA INC.)

F11

First . . . See an Otologist

(ear, nose and throat doctor)

A hearing loss is a health problem, and should be diagnosed by a medical doctor. For the name of the otologist, ask your family doctor, your local medical society, a local hearing society or hearing and speech clinic. An otologist may recommend medical or surgical treatment or may refer you to an audiologist for further testing.

Who is an Audiologist?

An audiologist is professionally trained to evaluate hearing, to advise about hearing aids, and to provide counseling services for hearing-impaired people. Some audiologists are in private practice, some are employed by physicians, and some work in hearing and speech centers or in audiology clinics.

If your hearing loss cannot be treated medically or surgically, the audiologist can identify symptoms and/or problems related to hearing loss, discuss the types of communication problems you may experience, and make recommendations about how you can make better use of your hearing.

What If a Hearing Aid Is Recommended?

If, after a complete evaluation, the audiologist thinks that a hearing aid might help you, another test, called a hearing aid evaluation (or hearing aid selection) will be scheduled for you. You will be tested with different hearing aids. Afterwards, the audiologist can recommend a specific brand and model of hearing aid which works best for you. Some audiologists are also dispensers, in which case you can purchase the aid from them. Otherwise, you will be referred to a hearing aid dispenser, from whom you can purchase the aid. Dispensers are required to provide the aid for you on a thirty-day trial basis. You may be asked to pay a deposit or even the full amount toward the aid. This will vary with different dispensers.

If at the end of the 30-day trial period or at some point *before* the trial time is over, you feel the aid is not benefiting you, you have several choices:

1) Consult the audiologist who recommended the aid. You should have a follow-up appointment with your audiologist before the end of the thirty-day trial period to discuss any problems. The audiologist, together with the dispenser, may change the aid; or
2) You may decide that a hearing aid does not benefit you in problem situations and you return the aid to the dealer and terminate the trial. If the trial is terminated, the dispenser will refund your payment minus the cost of the ear mold and loan fee. Of course, it is always important to clarify *ahead* of time what the costs will be during or at the end of the trial period. We cannot speak for *all* dispensers, but this is the general policy of most dispensers in the Bay Area.

Please Note

There is no good or bad brand of hearing aid. All companies make hearing aids with varying specifications. The aid which works best for you depends on the nature of your hearing loss. An audiologist is the best person to help you determine which aid will help you the most. Some hearing aid dispensers may claim to be able to diagnose your hearing loss and hearing aid need without a doctor's advice or professional consultation. Since a hearing loss is a health problem, we recommend that you first seek and follow the advice of an otologist and audiologist.

What Else Can You Do?

In some hearing losses, medical treatment will not help, nor will a hearing aid be useful. However, whether or not you use a hearing aid, the following activities are recommended.

1) Participate in an aural rehabilitation program to aid you in coping with your communication problems. Aural rehabilitation courses, for hearing impaired people and their families, are led by audiologists and provide information and support regarding many areas of communication and how hearing loss may affect it. To find out where these courses are held, ask your doctor, your audiologist, a local audiology center, hearing and speech center, hearing society, or state speech and hearing association.

2) Seek counseling. A hearing loss can cause personal difficulties for you and your family. It can affect your employment, your relationships with other people, or your feelings about yourself. Counseling is often helpful. Information on counseling services is available from the same sources mentioned above.

F12

COME AND LEARN ABOUT:

- Techniques for more effective communication.
- Types and causes of hearing loss.
- Why you sometimes "hear" but do not understand.
- How lipreading can improve your understanding.
- Ringing in the ears and what you can do about it.
- Different types of hearing aids.
- Special devices to help you in specific situations, such as on the telephone, in church and at group meetings.
- Consumer organizations for people with hearing loss.

The Hearing Society Direct Services

AUDIOLOGICAL COUNSELING – Licensed staff audiologists offer advice and information pertaining to hearing aids, communication modes and special devices available to improve communication

HEARING AID LOAN PROGRAM – Donated hearing aids are renewed and made available to clients at a minimal cost

AURAL REHABILITATION AND COMMUNICATION INSTRUCTION – Classes on hearing loss, hearing aids and effective communication techniques are taught regularly by trained specialists

CENTER FOR THE EDUCATION OF INFANT DEAF (CEID) [illegible] progr[illegible] [illegible]tion [illegible] in fo[illegible] [illegible]om [illegible] [illegible]d th[illegible]

PROGRAM COMPLETED

COUNSELING AND PSYCHOTHERAPY – Private sessions are conducted by professional social workers for both hearing impaired individuals and their families

SUPPORT SERVICES – Social and environmental adaptation programs are developed and integrated into the lives of clients based on their needs

The Hearing Society Community Programs

DIAL-A-TEST: Call (415) 776-1291 and screen your hearing

CONSULTATION: Service is offered to other agencies and groups to educate them on how to meet the needs of hearing impaired people

PUBLIC EDUCATION: Information is disseminated about hearing loss and available services, referral programs and consumer advocacy, plus literature in 13 languages

DEVICES DISPLAY: Equipment available to aid hearing impaired people is on permanent display and may be tried by clients

HEARING OUTREACH PROGRAM: Mobile van takes hearing screening equipment into community and work centers

DISCUSSION GROUPS: Focused outreach programs provide support for groups such as hearing impaired adolescents who are mainstreamed into public school settings

HEARING SOCIETY
FOR THE BAY AREA INC

HEARING RE-EDUCATION PROGRAM
(Aural Rehabilitation)

Sponsored By:

HEARING SOCIETY for the Bay Area
1428 Bush Street
San Francisco, CA 94109

775-5700 (voice)
776-DEAF (TDD)

HAVE YOU NOTICED THAT..........

-- People seem to mumble and speak too fast?

-- Your family complains that you turn up the T.V. too loud?

-- You have difficulty understanding on the telephone?

-- You have to strain to hear when in church, at the movies or at family and social gatherings?

IF SO..........................

F12

A COURSE IN HEARING RE-EDUCATION

MAY BE JUST THE THING FOR YOU!

The goal of "Hearing Re-education" is to improve an individual's communication skills. Activities, information and discussions are designed to focus on problems areas and help develop all potential means of communication in the home, at work and in social situations. Each course includes from two to five sessions and attending all sessions is important.

Family and/or friends are encouraged to participate in the courses to learn how to communicate more effectively with persons who have hearing problems.

****

FEES: Please note that fees for comparable courses at other centers in the Bay Area range from $60.00 to $200.00. The programs and services offered by the HEARING SOCIETY are supported primarily through tax-deductible contributions. If you are unable to make a contribution of $60.00 or more, please indicate that on the application and a partial or full scholarship can be arranged for your attendance at the course. No one is denied services because of the inability to pay. We do ask that you contribute what you can at the end of the course.

1986 SCHEDULE

SERIES 1: MONDAYS
(1:00-3:30)
February 24
March 3
March 10
March 17
March 24

SERIES 2: SATURDAYS
(9:30-4:00)
April 12
April 19

**SERIES 3: WEDNESDAY
(1:00-3:30)
May 7
May 14
May 21
May 28
June 4

**SERIES 3 WILL BE HELD IN OAKLAND AT
A CENTRAL PLACE
477 15th Street
Second Floor Conference Room
Oakland, CA 94612
Phone: 834-7897

SERIES 4: TUESDAYS
(1:00-3:30)
June 17
June 24
July 1
July 8
July 15

SERIES 5: WEDNESDAY EVES.
(6:00-8:30 p.m.)
July 30
August 6
August 13
August 20
August 27

SERIES 6: TUESDAYS
(9:30-4:00)
September 16
September 23

SERIES 7: Wednesdays
(1:00-3:30)
October 8
October 15
October 22
October 29
November 5

SIZE OF CLASSES IS LIMITED SO COMPLETE AND RETURN THE ENCLOSED APPLICATION TO RESERVE YOUR SPACE IN ONE OF THE SERIES. REMEMBER*** PLEASE PLAN TO ATTEND ALL THE SESSIONS IN THE SERIES YOU SIGN UP FOR.

**A Central Place is located one block from the 12th Street BART Station, on the walkway between Broadway and San Pablo. If you are driving, parking is available behind City Hall or at the City Center Garage at 14th Street and Webster. For additional directions call 834-7897.

HEARING SOCIETY for the Bay Area, Inc.
1428 Bush St., San Francisco, CA 94109

Telephones: 775-5700 (voice)
776-3323 (tdd)

F14

HEARING AID LOAN PROGRAM

What is the Hearing Aid Loan Program?

The HEARING SOCIETY can loan a hearing aid to people unable to purchase one for themselves. You may keep this aid for as long as you need it and live in the Bay Area. We ask that if you move out of the area or no longer need the aid, you return it to the HEARING SOCIETY.

How does the program work?

The HEARING SOCIETY collects hearing aids donated by concerned individuals and has them reconditioned. The hearing aids are then loaned out to people eligible for the program.

Who is eligible?

Anyone who:
- a) lives in the San Francisco Bay Area (Counties of San Francisco, Alameda, San Mateo, Marin, Contra Costa),
- b) has had a medical and audiological evaluation within the last six months and has been told by the doctor and audiologist that a hearing aid may be helpful,
- c) cannot afford to purchase a new hearing aid and is not eligible for one under Medi-Cal, California Children's Services (CSS), Department of Rehabilitation, or private insurance.

What are the steps in getting a hearing aid through the Loan Program?

1. Complete the attached Intake Information Form and mail it to the HEARING SOCIETY. After the form is received at the agency, an appointment schedule will be sent to you.

2. FIRST appointment: The audiologist will discuss with you specific information about your hearing loss, hearing aids, and communication patterns. If it is determined that you can benefit from a hearing aid, an impression of your ear will be made during this appointment which will be used for making an ear mold. If it is decided that a hearing aid is not appropriate, other recommendations will be made.

3. SECOND appointment: This will be about one week later. The audiologist will fit you with a loaner hearing aid and explain how to use the aid, assist you with adjustments, and how to insert the mold properly in your ear.

4. THIRD appointment: After using the hearing aid for about one week, you must return for this follow-up appointment. At this time, any problems you may have had in using the aid or in making adjustments can be discussed. There may also be additional audiological testing at this appointment.

5. A hearing aid rarely solves all of the problems associated with a hearing loss; and therefore an appointment with the social worker is usually scheduled at some point in the loan process to discuss any concerns you may have. Information on additional support resources in the community is also discussed in the meeting with the social worker.

F15

The hearing aid is yours to use as long as the aid is serving you well. A future follow-up appointment (after six months or one year) will be needed. You will be notified of any future appointments by mail.

What is the cost?

There is a fee of $40 for processing the hearing aid loan. This fee is applied toward the cost of making one ear mold and any repair costs that may be necessary before we can make the aid available for loan. This fee does not entirely cover repair and ear mold costs, nor does it cover the cost of staff time or any portion of the on-going costs of running the HEARING SOCIETY. Therefore, additional contributions are encouraged.

The fee should be paid when you receive the hearing aid (on your second appointment). If you have financial concerns regarding payment of this fee and wish to discuss this with us, please indicate this on the Intake Information Sheet.

If the hearing aid is lost or damaged while in your possession, another processing fee will be charged for a replacement. If, for reasons beyond your control, the aid stops functioning properly within six months from your receiving the aid, we will repair or replace the aid without a second processing fee.

What are my responsibilities?

The hearing aid is provided with the expectation that it will be used and will be helpful. If, for any reason, you are not using the aid, we should be notified immediately; it may be possible to adjust the hearing aid or to help you learn to adjust to the use of amplification. If you decide not to use the hearing aid, the aid should be returned to us promptly so that it can be made available to another person.

What else is there?

As mentioned earlier, a hearing aid rarely solves all of the problems associated with a hearing loss. The HEARING SOCIETY offers classes to develop communication skills and also individual or family counseling with the audiologist or the social worker. We encourage anyone interested in these services to talk with us.

Member Agency: United Way of the Bay Area

F16

HEARING SOCIETY for the Bay Area, Inc.
1428 Bush Street, San Francisco, CA 94109

Telephones: 775-5700 (voice)
776-DEAF (TTY)

HEARING AID LOAN PROGRAM

The HEARING SOCIETY operates a hearing aid loan bank for the purpose of assisting people who are unable to obtain new hearing aids. To maintain the program, the HEARING SOCIETY depends upon donations of used hearing aids and continuing financial support.

WHO IS ELIGIBLE? Any resident of the San Francisco Bay Area (San Francisco, Marin, Alameda, Contra Costa, and San Mateo Counties) who has been advised by an ear doctor and an audiologist that a hearing aid may be beneficial; who is unable to afford the purchase of a new aid; and who is not eligible for a hearing aid under Medi-Cal, California Childrens Service (CCS), Department of Rehabilitation, or private insurance. The medical and audiological evaluations must have been completed within the past six months.

HOW IT WORKS: The HEARING SOCIETY publicizes the need for donations of hearing aids, and evaluates each hearing aid received. The donor receives a statement of the aid's estimated value. Each hearing aid is measured electronically; some go directly into the loan stock, and some must first be repaired.

When an individual is referred for a hearing aid loan, an appointment is set up with the social worker. In this interview, the social worker (1) determines eligibility for the Hearing Aid Loan Bank Program, (2) ascertains that all necessary medical and audiological information is complete, and (3) discusses other agency and community services which might be helpful to the individual.

If the client and social worker agree that a hearing aid loan is appropriate, an appointment with the audiologist is arranged. At the first appointment, the audiologist usually makes an impression of the ear. The impression is then mailed to a laboratory, and an earmold is made and returned to the HEARING SOCIETY. Meanwhile, the audiologist determines whether or not there is an aid appropriate for this client in the hearing aid loan stock. When the appropriate aid is in stock, and after the earmold has been received from the lab, an appointment is set up for the client to be fitted with the hearing aid. If there is no suitable hearing aid at the time of the client's initial appointments, the client is put on a waiting list and notified as soon as an appropriate hearing aid is available.

After receiving the aid, the client is asked to come to at least one follow-up appointment to insure that there are no problems in manipulating the hearing aid and the earmold and that the client is adjusting to the use of amplification. Aural rehabilitation and/or lipreading courses are an integral part of the adjustment process, and may be recommended at this time.

The client may keep the hearing aid as long as it is being used and as long as the client remains eligible for the program. If financial circumstances change and it becomes possible for the client to purchase a hearing aid, we ask that this be done and that our loaner aid be returned to the HEARING SOCIETY. If the client moves out of the San Francisco Bay Area, the aid must be returned.

WHAT WILL THIS COST? Since most insurance programs, including Medicare, cover part of the cost of diagnostic services, it is usually possible to obtain medical and audiological evaluations at modest cost to the individual. If an individual cannot affort private diagnostic services, there are hospital clinics which provide services on a sliding-fee scale.

(over)

F 17

There is a non-refundable processing fee of $25.00 for the hearing aid loan. This fee covers the cost of making one earmold and any repair costs that may be necessary before we can make the aid available for loan. This fee does not cover the cost of staff time or any portion of the on-going costs of running the HEARING SOCIETY. Therefore, additional contributions are encouraged.

If the hearing aid is lost or damaged while in the client's possession, another processing fee will be charged for a replacement. If, for reasons beyond the client's control, the aid stops functioning properly, we will repair or replace it without a second processing fee.

CLIENT'S RESPONSIBILITIES: Proper fitting of a hearing aid depends upon accurate and current diagnostic information. The HEARING SOCIETY does not provide medical or audiological diagnostic services. Therefore, it is necessary for the client to see a medical ear specialist (otologist) and an audiologist before a hearing aid can be issued by the HEARING SOCIETY. Anyone who uses a hearing aid should have a hearing test by an audiologist at least once every two years. A medical examination may be recommended at the same time. The HEARING SOCIETY staff may recommend more frequent re-evaluations if indicated. We ask that the client obtain medical and audiological care as recommended; the client, then, should request that all pertinent reports be sent to the HEARING SOCIETY.

The hearing aid is provided with the expectation that it will be used and will be helpful. If, for any reason, the client is not using the aid, we should be notified immediately; it may be possible to adjust the hearing aid or to help the client learn to adjust to the use of amplification. If the individual decides not to use the hearing aid, the aid should be returned to us promptly so that it can be made available to another person.

The HEARING SOCIETY is ready to assist with any problems in the use of the aid. But, since we serve many people, our time is limited; therefore, appointments need to be scheduled in advance. If a client needs to change or cancel an appointment, it is imperative that we be notified as soon as possible.

ANSWERS TO COMMON QUESTIONS:

If I can afford a hearing aid but I want to find out if it really helps me, can I use the Hearing Aid Loan Program? No; the loan bank is not set up for that service. To find out if an aid helps, it is best to have a hearing aid evaluation by an audiologist, and then obtain the aid which is recommended on a thirty-day trial period.

Can I get the aid immediately? No; all of the steps described above are essential, and they usually require two or three weeks to complete. We will do our best to accommodate a person in urgent need within the limits of available time and resources.

If I obtain one hearing aid myself, can the HEARING SOCIETY provide a second aid? Occasionally, if the person's hearing loss is such that binaural amplification is important. Usually it is possible to provide only one aid for each person.

What else is there? A hearing aid rarely solves all of the problems associated with a hearing loss. The HEARING SOCIETY offers classes to develop communication skills and also individual counseling with the audiologist or the social worker. We encourage anyone interested in these services to talk with us.

Member Agency: United Way of the Bay Area 1/80

HEARING SOCIETY
(FOR THE BAY AREA, INC)

1428 Bush Street,
San Francisco, CA 94109

A United Way Agency

Thank you for supporting programs and services
for deaf and hearing impaired people
in the greater Bay Area

F1c,

Yes, I would like to contribute to the work of

HEARING SOCIETY
FOR THE BAY AREA, INC

________________ enclosed as my Membership Contribution.

(All contributions are tax deductible)

Patrons	$1,000 and up
Benefactors	500 and up
Sponsoring Members	125 and up
Sustaining Members	75 and up
Regular Members	35 and up

NAME ________________________________

ADDRESS ______________________________

CITY ____________________ ZIP __________

A contribution of:

$50	reconditions a donated hearing aid
$75	in-service, community education workshop
$125	provides an Aural Rehabilitation/Hearing Re-Education course for one person
$150	provides a needy person with a hearing aid evaluation, hearing aid, ear mold, and follow-up
$500	provides 10 hours of intense family counseling
$1000	buys new hearing aids for two children

THANK YOU!

F20

Congress of the United States
House of Representatives
Washington, D.C. 20515

WILLIAM E. DANNEMEYER
39TH DISTRICT, CALIFORNIA

COMMITTEES:
ENERGY AND COMMERCE
JUDICIARY

June 29, 1987

Alice
CBC

Kip and Betty Miller
Orange Hearing Aids
1234 West Chapman Avenue
Suite 105
Orange, California 92668

Dear Mr. and Mrs. Miller:

Thank you for your recent letter to Congressman Dannemeyer regarding the competition you have been experiencing from Providence Speech and Hearing. He understands your concern.

Despite our long standing support of Providence and its programs, we must concur that a non-profit organization may not compete against a commercial operation and still qualify for its special status. Therefore Congressman Dannemeyer has brought the matter to the attention of the Internal Revenue Service, which is responsible for the review and enforcement needed in this situation.

Because this involves the tax status of a third party, we cannot expect to hear from the IRS in response to Congressman Dannemeyer's correspondence. Privacy laws prevent the IRS from responding unless we have written authorization from the taxpayer—in this case, Providence Speech and Hearing—to look into their tax matters and to receive information from the IRS.

This does not in any way mean that the IRS will not pursue this matter, however. We just cannot be made a party to that investigation.

Thank you for bringing this to our attention. Should you have further news or questions, please do not hesitate to contact me at the district office.

Sincerely,

Mike Bonk

Mike Bonk
Senior Staff Assistant
WILLIAM E. DANNEMEYER
Member of Congress

WASHINGTON OFFICE: 1214 LONGWORTH HOUSE OFFICE BUILDING, WASHINGTON, D.C. 20515, (202) 225-4111
DISTRICT OFFICE: 1235 NORTH HARBOR BOULEVARD, SUITE 100, FULLERTON, CA 92632, (714) 992-0141

F21

EAR OF THE LION FOUNDATION
OF
CALIFORNIA-NEVADA, INCORPORATED

EAR OF THE LION FOUNDATION PATIENT REFERRAL PROCEDURES

IMPORTANT INFORMATION FOR HEARING CONSERVATION CHAIRMAN OR OTHER LION IN CHARGE OF REFERRALS. PLEASE READ CAREFULLY BEFORE FILLING OUT PATIENT REFERRAL FORM.

Membership donations and other contributions to the EAR OF THE LION FOUNDATION insure the availability of needed ear care for people in your community who cannot afford private care, do not have adequate insurance to cover the cost, are not eligible for government coverage of such needs, or have no other means of obtaining such care and services. All applicants applying for treatment and care through the EAR OF THE LION FOUNDATION must be sponsored by a member Lions Club.

As the Lion in your Club in charge of referring patients to the EAR OF THE LION FOUNDATION, it is your responsibility to screen local applicants so that our resources will continue to meet all legitimate needs. Authorizing service for someone who can afford to pay, or for someone who can receive service through other channels may deprive another qualifying applicant of needed medical attention.

In all cases, before any treatment is considered, the "PATIENT REFERRAL FORM", the "PATIENT'S FINANCIAL STATEMENT AND APPLICATION", and an "AUDIOMETRIC PROFILE" must be submitted by the Sponsoring Lions Club to the EAR OF THE LION FOUNDATION at 701 Welch Road, Suite 1119, Palo Alto, CA 94304. Lions Clubs may obtain the necessary forms by writing to the above address, or by calling the Foundation at (415) 494-1266.

It is the responsibility of the local Lions Club, through a Lion or a committee of Lions to determine a patient's eligibility for free ear care through the EAR OF THE LION FOUNDATION, using the following eligibility criteria:

FINANCIAL ELIGIBILITY

1. A. Family income (Husband and Wife) net income may not exceed $15,000.00.
   B. Family income (Husband and Wife with one child) net income may not exceed $16,000.
   C. Family income (Husband and Wife with two children) net income may not exceed $17,000.
   D. Family income (Husband and Wife with three children) net income may not exceed $18,000.
   E. Family income (Husband and Wife with four children) net income may not exceed $19,000.
2. Liquid assets may not exceed $3,000, including cash, stocks, bonds, etc.
3. Fixed assets: In the event an applicant is unable to assume charges at the present time, but has assets in excess of $50,000, he/she will be asked to sign a statement promising to repay the Foundation for costs of care at any such future date as the assets are liquidated or transferred, or he/she is otherwise able to do so. The Foundation will provide legal documents to accomplish this.
4. In the event an applicant has no income or assets and is being supported by a relative or others who are legally responsible, such persons must submit financial information concerning their income, assets, etc.

F22

EAR
OF THE
LION

A FOUNDATION FOR HEARING
Patient Treatment • Public Education • Medical Research
TO END THE SILENCE OF DEAFNESS

EAR OF THE LION HEARING AID BANK

The EAR OF THE LION FOUNDATION is a Non-profit Hearing Foundation, specifically created for and devoted to the diagnosis, treatment and care of hearing defects, research upon causes and correction of hearing defects, and general public education concerning causes and prevention of hearing impairment.

In our efforts and overall objectives to provide comprehensive treatment and care, the Foundation is actively involved in providing surgical assistance and treatment to the needy for hearing defects. Our efforts however do not end here. Some hearing defects are not correctable by surgery, but are aided by the use of hearing aids. As such a special program was created, the EAR OF THE LION HEARING AID BANK. The specific purpose of this program is to provide hearing aids, on a loan basis, to indigent persons where there is no other source of help available. Hearing aids that are provided are used hearing aids that have been donated to the Foundation and thoroughly reconditioned.

The application for a hearing aid must be initiated by a Lions Club, as the applicant's sponsor. All questions on the application must be completed, and the financial need of the applicant carefully screened by the sponsoring Lions Club prior to the submission of the application to the Foundation.

Every application must be forwarded to the Ear of the Lion Foundation for approval, and must be accompanied by the following: 1). A doctor's statement advising that the hearing loss cannot be corrected by surgery or medication, or a signed Waiver Form (available from the Foundation), waiving this requirement of the law, and 2). A copy of an audiogram to determine the need for and the strength of the hearing aid.

The fitting of the hearing aid will be done at a facility near the applicant's residence that has a working agreement with the Foundation and is licensed for making ear molds and doing fittings.

When an application is approved the Foundation will notify the applicant of the nearest facility, requesting that the applicant make an appointment with the facility for fitting. At the time of fitting the applicant will be required to complete and sign the Loan Agreement Form sent with each hearing aid loaned.

Application forms may be obtained by contacting:

EAR OF THE LION FOUNDATION
HEARING AID BANK
701 Welch Road, Suite 1119
Palo Alto, CA 94304

F23

RESIDENCY REQUIREMENT

The patient must meet the following criteria:

1. One year or more of continuous residency in the communities served by the **EAR OF THE LION FOUNDATION OF CALIFORNIA-NEVADA, INC.**
2. Anyone not a citizen of the United States or a lawful, permanent resident, applying for services must receive prior approval from the Board of Trustees.

MEDICAL NEED

It must be determined that the patient does indeed have an ear problem that requires treatment and care. In most instances the patient will have seen his own physician or ear doctor and will have been advised that further professional attention is needed. If the applicant has not been examined he/she must be seen by a local ear doctor or physician to ascertain that ear care is required, and what type of care is required (i.e. Surgery or Hearing Aid). The cost of such local ear care must be paid by the individual's insurance coverage, etc., or out of pocket, or by the sponsoring Lions Club itself.

PATIENT REFERRAL PROCEDURES

Once the patient's medical and financial needs have been established, the Patient Referral Form must be completed and forwarded in triplicate to the **EAR OF THE LION FOUNDATION.** For surgical referrals, the local doctor's diagnosis and signature must appear on the form. For hearing aid referrals, the appropriate examining personnel should enter the diagnosis and sign the form. In both referral situations an Audiometric Profile including Air Bone and Speech must accompany the Patient Referral Form. The patient should take the referral form to his local doctor at the time of his/her appointment and ask that it be filled out and mailed either to the Lions Club or to the **EAR OF THE LION FOUNDATION.** The section of the form referring to the sponsoring Lions Club should be completed prior to the form being submitted to the ear doctor's office. The Patient's Financial Statement and Application for Ear Care must also be submitted in triplicate to the Foundation. When a referral has been approved by the EOL Screening Chairman, the patient will be contacted by the Foundation regarding an appointment for the appropriate ear care procedures.

When surgical procedures or hearing aid fitting appointments are approved and scheduled by the Foundation, the patient or the sponsoring Lions Club is responsible for transportation to and from the location where ear care is being provided by the Foundation. The cost of lodging for anyone accompanying the patient, and in rare instances for the patient when out-patient tests and treatments cannot be completed in one day, shall be the responsibility of the individual concerned or of the sponsoring Lions Club. Personal charges incurred by a hospitalized patient (e.g. television, telephone, delayed departure at the convenience of the patient) will not be paid by EOL. The patient will be asked to pay any such charges upon discharge from the hospital.

In summary, sponsoring Lions Clubs are responsible for the preliminary diagnosis and doctor's visit, travel and housing, and if applicable, hearing aid fitting (including ear mold costs). The **EAR OF THE LION FOUNDATION** is responsible for all hospital medical care expenses, hospitalization, anesthesia, and surgery, and if applicable, the loan of hearing aids.

EAR OF THE LION FOUNDATION
701 Welch Road, Suite 1119
Palo Alto, CA 94304
Phone (415) 494-1266

Conclusion & Suggestions

The California Business Coalition agrees with much of what the Department of The Treasury states in its' position paper. Congress should be the entity to exam the non-taxable commercial abuses the not-for profit-entities have created to increase their revenue and avoid taxes. The Department of the Treasury seems to be requesting a redefinition or patching of the IRS Code pertaining to tax-exempt and non-profit organizations. We, on the other hand, request a complete rewriting of the IRS Code granting non-profit or tax-exempt status and respectfully suggest a few possible alternative revisions.

1. A new rationale of how an organization, group or entity is granted a tax-exempt or non-profit status with the requirement of a precise specific purpose to be part of the Charter. This specific purpose should include intent of the group, the quantity of need for the service, and the limits to the monitary growth. A new definition of the term "charitable" seems to be necessary. (Possibly: benevolent, philanthropic, good-will, love of mankind, providing aid, comfort and help to the indigent, disabled, sick or dying). Limiting the granting of tax-exempt or non-profit status to organizations that derive the primary source of income from benevolent donations, property donated or federal or state funding and who offer their services, products or facilities to the public Free Of Charge.

2. The non-profit or tax-exempt entity should be required to maintain separation from any branch, subsidiary or chapter that engages in a profit producing business.
   a. Maintain separate money and accounting records
   b. Utilize separate facilities, personnel and equipment.

3. Redefine terms such as "commercial activities", "revenue profits", "substantially related", to include advertising, marketing, sales and solicitation of products or services to the public. Taxable income should include those moneys' received from the billing of services or products to federal or state insurance programs.

4. Profit revenues should NOT be siphoned to administration costs, maintenance, salaries, investments or enterprise expansion.

5. A Specific deduction of a minimal sum should be allowed, when the profit from an unrelated business activity is insignificant (i.el Girl Scout Cookies, Bibles, wheel chairs- to the dying) and this should NOT be the primary source of revenue.

6. When a Charter, states that one of the purposes of a tax-exempt organization is the creation of a for-profit charitable commerical venture should be very closely examined, before granting tax-exempt status. A commerical activity should not benefit the non-profit and a completely separate business should be established. *(If the Laws or Regulations are changed, existing tax-exempt commerical businesses should be required to completely dismantle before re-startup is possible, including personnel, equipment and assets. If the laws and regulations are changed it would be the prerogative of Congress to collect retroactively on taxable income.)

These are afew of the suggestions from the CBC, which we feel should be included in the writing of new Laws, Regulation or IRS Codes. New and inventive tax abuses will occur as is evidenced in the meeting held by the United Way Agencies Task Force (minutes attached).

One final point that the California Business Coalition would like to express to Congress, is the unseen aspect of this whole dilemma--FEAR. Business owners, employees or anyone who contributes time or money, is a member of or belongs to a non-profit tax-exempt group, FEARFUL to step forward and publically criticise such organizations. These people are afraid of business repercussion, an increase in the tax-exempt abuses, retailation or peer pressure. Many people have stated to me that "the problem is SO BIG, you can't beat them, so...you might as well join them". This fear has been expressed to me many times, and so real is the fear factor that many abuses by tax-exempt non-profit entities have gone unreported or unchallenged. We feel that public hearings, requests from Congress, or IRS investigation will bring forth evidence from these people.

The California Business Coalition would welcome the opportunity to work with The Chairman, The Committee or their staff in collecting evidence and examples. We would also welcome the opportunity in participating in the drafting or passing of legislation which we hope will result from this study, of what we believe to be an extremely serious problem.

CALIFORNIA BUSINESS COALITION
PARK EXECUTIVE BUILDING 926 L STREET SUITE 220 SACRAMENTO, CA. 95814
NORTH STATE 800 341-1441 SOUTH STATE 800 732-3532

Attached are evidence and examples of tax-abusive schemes. Also a copy of "Little Hoover Report" from the State of Califronia and the United Way meeting minutes.

The attachments include:

A-1-18 1. Report by the Little Hoover Commission on the extent of State and Local Government business activities, which appear to compete with private enterprise.
UW1-33 2. Minutes from the meeting of Small Business& Non-proifts Relations, October 1986
MCA1-4 3. Reports on the YMCA in California and advertising documents
UW22-33 4. Facts book and Agency Directory for United Way of the Bay Area
G1-2 5. Cancer Prevention Project
6. St. Rose Hospital - upon request - too thick
11-6 7. Pacific Legal Foundation Documents
8. San Leandro Boys Club- Bingo paper
I1-2 9. St Joseph Senior Center
J1-3 10. The Center of Constructive Alternative/ Hillsdale College
N4-7 11. Citizens for Decency Through Law Inc.
12. The Salvation Army-mailing list must have been purchased
K1-12 13. The Tri-City Church of Religious Science
14. The Foundation for Glaucoma Research upon request
15. San Francisco Preventative Medical Group upon request
21-5 16. The Society from Public Health Education Inc upon request
L1-5 17. Ciracs Inc.
R1-4 18. Letters From job agency's
X1-9 19. Newpaper with advertisements of Bingo Parlors
BCR1-4 20. Blue Cross/Blue Shield Advertisement-direct mail
21. Mayo Clinic
22. List of educational facilities--mail order/ advertising audiovisual/computer equipment
Example 1

Attached to each example in the body of the testimony is evidence for each case with letters from businesses that are directly affected by each.

CA1

STATE OF CALIFORNIA
GEORGE DEUKMEJIAN, Governor

COMMISSION ON CALIFORNIA STATE GOVERNMENT ORGANIZATION AND ECONOMY
1127 - 11th Street, Suite 550, (916) 445-2125
Sacramento 95814

Chairman
NATHAN SHAPELL

Vice-Chairman
JAMES M BOUSKOS

ALFRED E ALQUIST
Senator

MARY ANNE CHALKER

ALBERT GERSTEN JR

BROOKE KNAPP

HAIG G MARDIKIAN

MILTON MARKS
Senator

GWEN MOORE
Assemblywoman

MARK NATHANSON

M LESTER O'SHEA

JEAN KINDY WALKER

PHILLIP D WYMAN
Assemblyman

RICHARD C MAHAN
Executive Director

January 2, 1986

Honorable George Deukmejian
Governor of California

Honorable David A. Roberti
President pro Tempore of the Senate
and Members of the Senate

Honorable James Nielsen
Senate Minority Floor Leader

Honorable Willie L. Brown, Jr.
Speaker of the Assembly
and Members of the Assembly

Honorable Patrick Nolan
Assembly Minority Floor Leader

Dear Governor and Members of the Legislature:

The subject of government competition with private enterprise is one which has been of interest to the Legislature and the business community for a number of years. At the heart of the matter, some argue that the role of government should be limited to providing only essential services which cannot otherwise be provided by private enterprise or should be the province of government only when there are compelling policy issues such as those which may relate to public health and safety. Contrary to this view of the limited role of government, some argue that other factors such as the ultimate cost of services to consumers are a proper consideration of whether these services should be provided through government programs, free enterprise, or a regulated private sector.

This letter-report summarizes the findings of the Little Hoover Commission on the extent of State and local governmental business activities which appear to compete with private enterprise and may not be authorized by constitutional or statutory provisions. Based upon the information provided to our Commission by complainants and representatives of affected governmental agencies as well as our review of relevant statutes, we concluded that there are numerous instances of competitive governmental activities, but no identified cases of unauthorized or illegal activities.

BACKGROUND

In an opinion prepared in 1979 (Business Activities of State Agencies - #13101), the Legislative Counsel observed that in general no constitutional provision prohibits a State or public agency from entering into a business activity which is in direct competition with private enterprise, but statutory or constitutional authority must exist to permit the activity. Counsel observed that administrative agencies have no powers other than those conferred on them expressly or impliedly, and that this authority has traditionally been limited to activities which serve a public purpose since it is generally not a function of government to engage in profit-motivated activities.

There are so many instances of statutory authority which authorize State and public agencies to pursue business activities which are in direct competition with private enterprise that Counsel concluded "they are too numerous to list." Examples of such authority are as follows: the Regents of the University of California operating hospitals (see Secs. 92406 and 92432, Ed. C., and Sec. 9, Art. IX, Cal. Const.); the Department of General Services operating the State printing plant (see Ch. 7 commencing with Sec. 14850, Pt. 5, Div. 3, Title 2, Gov. C.); institutions of public higher education in this State operating student bookstores (see Secs. 81674 and 89905); the sale of timber from State forests by the Director of Forestry (see Sec. 4650, P.R.C.); the sale by the Department of Corrections of goods made by prisoners (see Secs. 2701 and 2702, Pen. C.); and the sale or exchange by any State agency of goods and products in excess of its needs (see Art. 5 commencing with Sec. 11330, Ch. 3, Pt. 1, Div. 3, Title 2, Gov. C.).

At the request of a number of legislative members, our Commission held a public hearing in June 1984 on the subject of government competition with private enterprise and voted to conduct a survey to determine whether there were a significant number of unauthorized competitive activities by State agencies. Subsequently, the Commission also followed up on various allegations concerning the competitive practices of local government agencies identified through correspondence with legislators or through our Commission's hearing process.

Since there is no declaration of legislative intent to prohibit State government activities which may be characterized as "competitive," and since there are as previously noted numerous examples of statutorily authorized business activities, our survey was not designed to address the propriety of public policy in cases of authorized governmental practices or services which may appear to compete with private enterprise. However, our survey was designed to provide reliable information on whether there are many instances of unauthorized governmental competition.

METHODOLOGY

Based in part upon issues discussed in our public hearing, a survey form (see Attachment 3) was designed to elicit at least preliminary information on competitive governmental activities. Although the primary purpose of the survey was to identify unauthorized activities, survey respondents were requested to report any "improper" competitive activities (survey item no. 4) in order to avoid inadvertently "screening out" potential survey respondents who might be unable to report on whether the governmental activities to which they objected were, in fact, unauthorized.

In November 1984, a total of 1,300 surveys were mailed to representatives of all the local chambers of commerce, lobbyists, and employers of lobbyists associated with businesses (approximately 600 and 700 persons respectively). Local chambers of commerce were included to ensure regional coverage of the State and the participation of small businesses which might not otherwise be surveyed within the limits of available resources. Additionally, legislative advocates were surveyed because earlier, limited surveys of governmental competition conducted by

Assemblyman Don Rogers found them to be knowledgeable and interested participants.

Approximately three months later, follow-up letters and surveys were mailed to all non-respondents. In both mailings, prepaid reply envelopes were enclosed to encourage a maximum number of responses.

Besides the 1,300 surveys sent to identify unauthorized State agency activities, the Commission followed up with 8 complainants who had earlier identified competitive activities by local governmental agencies. The Commission then sent copies of complainants' completed surveys to the affected government agencies and requested that they respond on any points of disagreement with alleged facts or interpretations of facts. All agencies responded to this request.

Finally, the Commission engaged in further fact-finding and analysis of statutes in a number of cases to determine whether the reported activity was an authorized business activity. This entailed making critical determinations concerning the factual basis and relevance of information submitted by complainants as well as the affected governmental agencies.

FINDINGS

Of the 1,300 mailed surveys of "improper competition" by State agencies, 284 or 21.8 percent were returned to the Commission. Forty-four of these surveys or 15.5 percent of the returns reported specific, verifiable allegations of competitive governmental activities with one of 15 governmental entities (listed on Attachment 1). Of these 44 complaints, 5 respondents (11 percent) characterized the activities they reported as unauthorized or unlawful while the remainder were nearly equally divided in expressing either belief that the activities were authorized or uncertainty whether they were authorized.

Based on research of facts stated in the complaints, governmental agency responses, and statutory authorities, the Commission concluded that all of the reported business activities of State agencies were authorized activities. Similarly, the Commission concluded that all of the local government competitive activities which we studied were also authorized activities. Illustrative cases of alleged governmental competition are presented as Attachment 2 to this letter-report.

In order to provide additional information on a number of policy issues which are associated with the Commission's examination of whether and how governmental entities compete with private enterprise, we analyzed complaints to produce the following typical profile of information concerning competitive governmental activities:

Economic Impact: Forty-three percent of the complainants reported that they could not estimate the Statewide economic impact of the activities on private enterprise. Additionally, 30 percent estimated the economic impact as being less than $100,000 of unrealized gross annual income, and 27 percent estimated an impact of $100,000 or more annually.

User-Fee: Thirty-six percent reported that they did not know whether consumers were required to pay a user-fee to the government agency for the cost of the service; 34 percent believed that a user-fee was charged to reimburse part or all of the agency's cost of providing the service; and 30 percent stated that there was no user-fee. For example, the Department of Recreation charges a fee for overnight use of its "day use" parking areas. This fee covers part of the actual cost of providing this service.

Profit: Thirty-nine percent believed that the agency did not make a profit from revenue in excess of its actual cost to provide the good or service; 25 percent said the agency made a profit; and 36 percent did not know whether there was a profit.

Benefits of Private Enterprise: Virtually all (91 percent) stated that they had specific information which suggested that private enterprise could provide comparable or enhanced service, efficiency, or economy if there were less governmental competition. Approximately half of these cited fairly specific arguments or information intended to support their assessment while the remainder did not offer specific corroboration.

Contracting Out: About two-thirds (64 percent) reported that they did not know of any precedent whereby the State agency had contracted with a business to provide these or similar goods or services to the public. Most of the 36 percent which stated that they knew of such a precedent cited a specific example.

Contact with Agency Administrative Staff: About two-thirds (68 percent) reported that they or a representative contacted an administrator at the competing agency in an attempt to resolve a complaint of government competition.

Role of Government: Forty-three percent expressed the laissez faire view that State agencies should relinquish all responsibility for the provision of the reported competitive services and instead rely entirely upon competitive forces in the private sector. However, 41 percent were evenly divided between the view that agencies should continue to directly provide their business activities, subject to certain controls, or should contract out their activities and monitor their cost and adequacy to protect consumers. The remaining 16 percent expressed views characterized as "other."

Of the 15 State agencies and quasi-governmental entities, our analysis found that 8 agencies were the object of one complaint each, while 7 other agencies accounted for the remainder of 36 out of 44 complaints. However, multiple complaints concerning any agency did not indicate that complainants were more likely to believe that the agency business activity was unauthorized.

SUMMARY AND CONCLUSION

The Commission's survey and analysis of State and local governmental activities which are perceived as being competitive with private enterprise found that each reported case was in fact authorized by statute. Based upon our survey of State activities, we conclude that it is unlikely that any State agencies currently engage in unauthorized business activities. Although we found that all the reported activities of local government agencies were also authorized, given the limited scope of our review, we have no conclusion concerning the probable results of what could be a more comprehensive survey in this area.

Respectfully,

LESTER OSHEA, Chairman
Government Competition
Study Subcommittee

NATHAN SHAPELL, Chairman
James M. Bouskos, Vice Chairman
Senator Alfred E. Alquist
Mary Anne Chalker
Albert Gersten, Jr.
Brooke Knapp
Haig Mardikian
Senator Milton Marks
Assemblywoman Gwen Moore
Mark Nathanson
Jean Kindy Walker
Assemblyman Phillip D. Wyman

CA -6-

ATTACHMENT 1

The following 15 State agencies and quasi-governmental entities (University campus auxiliaries) were alleged by complainants to engage in business activities which compete with private enterprise:

- University of California, Davis (including campus auxiliaries)
- California State University, Northridge
- State Department of Education
- Department of General Services
- Department of Transportation
- Department of Parks and Recreation
- Department of Forestry
- Department of Boating and Waterways
- Prison Industry Authority
- California Youth Authority
- California Highway Patrol
- Employment Development Department
- Department of Industrial Relations (State Compensation Insurance Fund)
- Department of Health Services
- Department of Rehabilitation

ATTACHMENT 2

ILLUSTRATIVE SUMMARY OF CASES OF ALLEGED GOVERNMENTAL COMPETITION

Department of General Services -- Building Maintenance Complaint: According to the complainant, the Department hired a painter in 1982 to paint three State office buildings in Stockton. Formerly, this work was sent out for bid to local contractors. The complainant states that this change in practice is unauthorized because it violates "force account limits." Force account limits are ceilings which allegedly constrain the Department from using in-house (State) staff for large projects. The complainant cited three instances where force account limits are applied: Stockton Unified School District ($2,500 limit), Stockton City ($8,000 limit), and Cupertino Union Elementary School District (unknown limit).

State Agency Response and Additional Information: The Department verified that it employed a painter to perform scheduled maintenance painting which had formerly been executed by private-sector contractors. However, the Department stated that the former contracting out of this work was not required by any applicable statute. Instead, this activity was characterized as "appropriate at that time" because the Department's Office of Buildings and Grounds had no painter assigned to this work. Subsequently, the Department assigned a painter to perform the specified work because this appeared to be an "economically sound practice for the State of California."

The Department concluded on the basis of consultation with its Legal Office that this complaint was unfounded because there is no statutory restriction -- by the name of "force account limit" or any other description -- which limits the amount of authorized maintenance work which may be performed by State employees.

Commission Conclusion: The examples of monetary limits on certain activities of school district or city employees do not establish that there is any statutory authority which would constrain the Department to contract out maintenance activities. It is an established principle that the director of any State agency may determine that agency employees may either perform or arrange for essential maintenance work on State facilities.

Department of Parks and Recreation -- Overnight Camping Complaint: The Department operates a program which permits overnight camping in "day use" parking areas although alternative private campgrounds and recreational vehicle parks allegedly operate at less than full capacity. According to the complainant, this program of "overflow" or "en route" overnight camping in day use areas is not a statutorily authorized activity of government.

State Agency Response and Additional Information: According to the Department's response, the Enroute Camping Program was the result of many public requests for a program which would accommodate overnight travelers.

The Department formulated a program which is said to be responsive to the traveling public without detracting from basic daytime use of facilities or entailing new capital outlay costs. Generally speaking, this program allows day user facilities to be used for overnight purposes during evening periods, returning to day use the following morning. The Department cites health and sanitation, visitor safety, and other public benefits of the program.

Additionally, the Department states that private enterprise benefits from the operation of State Park System units because they are a "major tourist attraction unto themselves" and attract visitors who are seeking "more than a simple overnight accomodation for their traveling needs." Visitors to the State parks reportedly stimulate the local economy through their purchase of various community services. Also, private campgrounds are said to feed off the overflow from adjacent State parks throughout the State.

Finally, the Department disputes the allegation that this program is not statutorily authorized.

Commission Conclusion: The Public Resources Code (Sections 5003, 5003.4, and 5019.5) authorize the State to provide camping programs. We know of no basis for assuming that this statutory authority is meant to exclude a specific program designed to accomodate overnight travelers. Additionally, annual budget allocations for the Department's overnight program constitute an explicit statutory authorization.

University of California, Davis -- Campus Food Services Complaint: Four merchants in Davis cited allegedly improper competitive activities in campus food service operations. Although none of the complaints disputed the authority of the University to provide for this service — a service traditionally provided on campuses throughout the country -- they expressed dissatisfaction with University policies in the following charges:

- The University provides its designated food service vendor (Service Systems) with space, equipment, and utilities at "below market value."

- Service Systems aggressively advertises and promotes its various food services at prices which compete with off-campus businesses.

- The University does not allow off-campus businesses to sell their food products on the campus.

State Agency Response and Additional Information: In general, the University response characterized the complaints concerning campus food service operations as "ironic" because these services constitute a major use of private enterprise to meet an important campus need. The University needs food services for its student residence halls and a selection of conveniently located luncheon and snack facilities to serve employees as well as students. It determined that it is most cost-effective to obtain these food services by contract with a private firm and consequently has done this since 1967. However, the University contract with Service Systems reflects a sensitivity to the Davis business community by requiring that this vendor use other local vendors as suppliers whenever possible.

The University provided further information disputing the facts or conditions of specific charges as follows:

According to the University, the assertion that space, equipment, and utilities are provided at "below market value" is incorrect. The food service contractor pays "rent" in the form of commissions averaging over 8% of cash and vending sales, which is said to be at least comparable to commercial rates for space rental. In addition, Service Systems pays the University for all building and equipment maintenance, utilities, custodial care, refuse, water and sewer, and grounds maintenance for all facilities in which they operate. The University does receive a lower rate for electricity than Davis merchants, as one respondent pointed out, but this is true for some other Sacramento Municipal Utility District customers as well.

The University acknowledges that Service Systems promotes its on-campus food services through advertising just as any other profit-making enterprise might. However, the University's contract limits its vendor's promotional activities to campus media and prohibits advertising in local newspapers or other commercial avenues. This limitation is the basis for the University's assertion that its vendor does not compete with local restaurants for off-campus customers.

Although Service Systems advertises in the "California Aggie" student newspaper with an off-campus circulation of approximately 1,300 of its 12,500 total circulation, the University states that it has no evidence that this results in the attraction of non-University customers. In support of this position, the University notes that it does not have the facilities to provide food services to more than a small proportion of the estimated 25,000 students, faculty, and staff which comprise the campus community. Additionally, the limited visitor parking on campus is said to constitute a strong disincentive to the attraction of potential customers from off-campus.

While the University agreed that its food service contract prohibits catering of events on campus by off-campus vendors, it argued that this practice is based primarily upon considerations of cost-effectiveness. The selection of a single vendor with exclusive rights for on-campus food service, vending machines, and catering reportedly enables the University to get a low comprehensive bid and to keep student residence hall fees as low as possible. Additionally, the use of a single contract is said to make it easier for the University to maintain appropriate controls over building access, public health, and related considerations. Finally, it disagreed with one complainant who suggested that departments or individuals are prohibited from purchasing food elsewhere for consumption on campus.

Commission Conclusion: The complaints concerning food services offered on the Davis campus are not so much concerned with competition between a

State agency and private enterprise as with a large, private-sector purveyor of food services competing to an indeterminate extent with other, typically smaller service enterprises. We did not attempt to investigate the extent to which limited off-campus advertising of on-campus food services might impact prospective patrons of off-campus restaurants.

City of Redondo Beach -- Recreation Facilities

Complaint: The complainant charges that in June 1975 the City gave approval to his firm to construct 4 rental tennis courts in the Kings Harbor area of Redondo Beach. Subsequently, the City allowed his firm to construct 2 additional rental tennis courts and 9 racquetball courts.

In October 1975, the City constructed a total of 8 rental tennis courts at Alta Vista within 2.6 miles of his Sports Center. After he built his approved racquetball courts, the City constructed 2 racquetball courts at its Alta Vista location.

According to the complainant, the City has competed with him by consistently undercutting his prices. For example, the City's hourly tennis court rentals in 1976 ranged from $2.00 to $3.50 while his Sports Center charged $4.00 to $6.00. Similarly, City tennis rentals in 1982 ranged from $2.50 to $3.50 while he charged $4.50 to $9.00.

The complainant's gross revenues from rental tennis courts reportedly declined from $73,228 in 1976 to $41,061 in 1982, allegedly because of this competition. He stated that the City grossed $36,192 from its rental tennis courts in fiscal year 1975-76, $58,914 in the following fiscal year, and about $50,000 in calendar year 1982.

Local Agency Response and Additional Information: The complainant is one of the master lessees in Redondo Beach. According to the City's response, the complainant's development option under the terms of the lease would have soon expired if he did not make some improvements to the property. Consequently, he elected to construct a tennis facility.

Before the complainant decided to build private tennis courts, there were approximately 24 public tennis courts in Redondo Beach — all operating on a no-fee, first come, first served basis -- and 8 more budgeted for construction. After the City built these courts at Alta Vista, it changed its system at this location from a free play system to one in which players pay a nominal fee to cover the City's actual cost of reserving guaranteed starting times. The City confirmed that it added 2 racquetball courts at this location and 6 more free play tennis courts at other locations.

The City contends, and the complainant does not dispute, that there is ample precedent and authority for it to provide for public sources of recreation. Additionally, the City states that these facilities and programs may benefit rather than compete with the complainant's private programs. Specifically, the City courts may introduce the public to sports which they would not otherwise have undertaken. Since public facilities do not offer the amenities provided at private facilities, some of these new tennis and racquetball enthusiasts may "graduate" to the latter facilities even though they are more expensive. The City recreation facilities at Alta Vista are described as "bare," lacking even shower and dressing rooms.

Commission Conclusion: Although the City recreation facility at Alta Vista may compete with the Sports Center, the facts of this case do not clearly establish either the extent of whatever competition may exist or that the City is the initiator of the alleged competition.

Since there were 24 free public tennis courts in Redondo Beach and 8 more budgeted before the complainant constructed private tennis courts, it appears that the complainant made a decision to initiate whatever competition may actually exist in providing tennis facilities. This decision may have been predicated simply on the perceived economics of being able to capitalize on a significant portion of the recreation market or may have been influenced by the City's requirement that he make some kind of improvements as a condition of retaining his master lessee status.

The complainant did not allege that he was unaware that the City intended to construct 8 tennis courts at the Alta Vista site 2.6 miles from his own prospective facility. The City's selection of its site was probably common knowledge months earlier because it had already been discussed, approved, and budgeted before June 1975.

The financial data reported by the complainant does not clearly establish that the proximate City tennis courts caused his Sports Center to lose revenues. Although he reported that his gross revenues declined 44 percent from 1976 to 1982, the City did not experience any growth in income from its tennis courts during this period. Based upon the fact that the City realized no more than 9 months of fiscal year 1975-76 income from its tennis courts constructed in October 1975, its calendar year 1976 income is estimated to be approximately $54,000. Therefore, decreased patronage of the Sports Center in the period 1976-1982 cannot be attributed to the City's Alta Vista courts since the latter experienced a nearly flat utilization in the corresponding period.

The City's decision in 1983 to build racquetball courts at Alta Vista 6 years after authorizing the Sports Center's racquetball courts might appear to be competitive. The complainant certainly would not have had foreknowledge of this development. However, the complainant did not present any information which might establish that this is probably, rather than merely possibly, a competitive situation. The reported lack of amenities at Alta Vista gives credence to the City's observation that it does not attract the Sports Center's clients. Additionally, there is no basis for supposing that the City's racquetball courts would be competitive although its tennis courts evidently are not. Finally, we learned that some of the City's user-pay classes rent racquetball courts at the Sports Center, thus mitigating the alleged competition.

County Clerk's Office -- Civil Marriage Services

Complaint: A representative of the Lake Tahoe Wedding Chapel Association complained that County Clerks compete with wedding chapels throughout California by advertising and performing marriages for a fee of $15.00. Supplemental information received from a representative of the California Wedding Chapel Association indicated that the Los Angeles County Clerk's Office performs about 7,500 marriage services annually, comprising about 11 percent of countywide marriages and 37 percent of about 20,000 marriages performed in Los Angeles City.

Local Agency Response and Additional Information: The history of County Clerks being able to perform marriages dates from 1974 when the law was changed to permit counties of 100,000 or more to have the County Clerk perform marriages (Sec. 4205.1, Civ. Code). In 1982, the population requirement was dropped. In 1984, the law was once again changed to state that any County Clerk was also an ex-officio Commissioner of Civil Marriages by virtue of holding that office. The law permits, but does not require, County Clerks to perform marriages.

According to the El Dorado County Clerk, who has a South Lake Tahoe office which allegedly competes with 7 local wedding chapels, there is no significant competition between her office and the local chapels. In fact, she states that her office performs an average of about 5 weddings per month while the local chapels perform an average of 625 weddings per month. Additionally, she states that her office does not advertise wedding services and routinely refers those who inquire concerning these services to the local wedding chapels.

Those who wish to be married by County Clerks are said to be motivated by 2 main factors. First, they may wish a secular or "civil" ceremony rather than one performed by a religious authority in a wedding chapel. Second, they may prefer the less expensive County wedding ($15.00) to chapel services which usually range upwards from a base of about $100.00.

We did not attempt to corroborate or disconfirm the statements of the representative of the California Wedding Chapel Association regarding the number of civil ceremonies performed in Los Angeles County and City.

Commission Conclusion: The law permits but does not require County Clerks to perform civil marriage ceremonies. However, the statute establishes the fee of $15.00 for any marriage ceremony performed by a County Clerk or designee. Therefore, whenever a County Clerk's office offers this service, it will significantly undercut the price of wedding chapel services.

One way of reducing the appearance or reality of competition would be for the State to require County Clerks to charge more for these services. However, this would result in higher costs to some consumers of the service even if wedding chapels did not increase their prices for services.

We conclude that there is very little competition between County Clerks and private wedding chapel operators in the South Lake Tahoe area where the complaint originated, but there may be significant competition in Los Angeles.

The determination of whether County Clerks compete unfairly with wedding chapels depends fundamentally on the personal and political perceptions of whether consumers should be afforded the opportunity to purchase a simple County service economically, at close to its actual cost, or whether all consumers should be required to pay at least the going rate of $100 or more charged by wedding chapels for more ornate and profitable services.

CA14

ATTACHMENT 3

SURVEY OF STATE GOVERNMENT COMPETITION WITH PRIVATE ENTERPRISE

Directions:

Please complete at least the initial four items including your identification, how you received this survey, whether you wish to receive a summary of survey findings when this available, and your observation of whether unauthorized competition is (or is not) a problem.

If you check the first alternative of item number four, indicating that you do not have direct knowledge of a problem, please disregard the remainder of this questionnaire and return your responses in the postage-prepaid wrapper addressed as follows:

Commission on California State Government Organization and Economy;
1127 - 11th Street, Suite 550; Sacramento, CA. 95814.

If you have specific information concerning competitive activities which may be unauthorized, please complete each item, attaching additional pages if necessary, and return your survey, postage-prepaid to the Commission by December 14, 1984.

1. SURVEY RESPONDENT: Please provide your name, identify your business or association, and include a telephone number where you can be reached if it is necessary to contact you in connection with this survey.

____
____
____
____

2. How did you receive this survey?

_____ Mailed directly to a local Chamber of Commerce which I represent.
_____ Mailed directly to a business I participate in or represent.
_____ Received from a local Chamber of Commerce (Which?
______________________________)
_____ Received from other source (specify).
____
____

3. Do you wish to receive a complimentary summary of survey findings when this is available?

__________Yes _________No

CA15

4. Do you know of any instance in which any State agency is engaged in what you consider to be improper competition with private enterprise?

_____ I do not know of any improper activities.*
_____ I have specific information about improper, competitive activities.

*If you indicated this alternative, please disregard the remainder of the survey as noted in the directions, but return your responses to the initial four questions.

* *

5. Do you know of different cases of improper competitive activities, that is, unrelated types of business activities which may be engaged in by one or more State agencies?

____One case only.
____More than one type of activity by one agency. (How many? ______)*
____More than one type of activity by more than one agency. (How many?__)*

*If you know of more than one case, describe the most severe case in the remaining items of this survey. (Base your judgment of severity on activities' relative economic impact on private enterprise.)

If you are aware of more than one case, please briefly summarize the less severe cases and attach the summary to this questionnaire.

6. Specify the State agency (and location) which is in competition with private enterprise.

7. Please identify at least one business entity which competes with the State agency in providing goods or services.

Name of Firm: ______________________________
Address: ______________________________

Suggested contact person and phone number if known:

CA16.

8. Describe how these State activities compete with or damage private enterprise. For example, does State business activity prohibit, restrict, or undercut the private sector's market for goods or services?

9. Can you estimate the economic impact of these activities on private enterprise in terms of unrealized gross income?

_____ Less than $5,000 annually.
_____ $5,000 or more, but less than $10,000 annually.
_____ $10,000 or more, but less than $100,000 annually.
_____ $100,000 or more, but less than $5,000 annually.
_____ $500,000 or more, but less than $1,000,000 annually.
_____ $1 million or more annually (specify: $_________)
_____ Can not reliably estimate.

10. To the extent that you can, summarize the history of State involvement in these activities including duration, recency, and scope.

11. To the best of your knowledge, do consumers pay a user-fee to reimburse the State agency for the full cost of providing these services, or do tax revenues directly subsidize the agency's cost of providing services?

_____ No user-fee.
_____ User-fee pays only part of agency's cost.
_____ User-fee pays entire cost.
_____ I don't know whether there is a user fee.
_____ There is a user-fee, but I don't know if it pays the entire cost.

CA17

12. Do you have reason to believe that the agency makes a profit from revenues in excess of its actual costs to provide the goods or services? If "Yes," please specify details.

________Yes ________No ________Don't know.

13. Do you have any specific information which suggests that private enterprise could provide comparable or enhanced service, efficiency, or economy if there were less governmental competition in the provision of these goods or services? If "Yes," please specify details.

________Yes ________No

14. Do you know of any business which has contracted to provide these or similar goods or services on behalf of this State agency? If "Yes," please identify.

________Yes ________No

15. If you or a representative have contacted any administrator at the competing State agency in an attempt to resolve your concerns or complaints, please indicate below. Additionally, summarize the agency response to your inquiry, or you may attach any correspondence which you consider relevant.

________Made contact ________No contact

Who?________

When?________

Where?________

16. "Unauthorized" State agency activities are those which are not authorized by constitutional or statutory provisions. Any activities which are conducted without express or implied authority are unlawful.

To the best of your knowledge, what is the status of the activity you have reported?

_____ The activity is authorized.
_____ The activity is not authorized.
_____ I do not know whether the activity is authorized.

17. Which alternative best expresses your view of the proper role of State agencies as it relates to the competitive activities you have described?

Indicate one of the following:

_____ Should continue to directly provide these goods or services, but the agency business activities should be subject to certain conditions or controls (specify); or

_____ Should contract out some or all of these activities to private enterprise, but should actively monitor their adequacy and cost to protect consumers; or

_____ Should relinquish all responsibility for the provision of these services and instead rely entirely upon competitive forces in the private, for-profit sector; or

_____ Other (please specify).

18. If you know of an instance where private enterprise could provide a good or service to a State agency on a more economical basis than another State agency which currently provides the good or service, please outline the circumstances being as specific as possible.

ADDITIONAL COMMENTS: Feel free to attach your additional comments relative to any items in this survey or other points which may be germane.

uw

United Way of California
410 Bush St San Francisco California 94108 • Phone (415) 772-4300

October 14, 1986

Alice J. Gallagher
Beltone Hearing Aid Center
1736 Telegraph Avenue
Oakland, CA 94612

Dear Ms. Gallagher:

On behalf of the United Way of California and all of the participants at the Small Business/Nonprofit Relations Roundtable, I want to thank you for joining us and for the information and insights you contributed.

I have heard from several United Way staff people who came to the meeting that they found it both interesting and enlightening. I am sure that they will take the information back to their local United Ways and use what they have learned to begin a process of information exchange with businesses in their communities.

The United Way of California will continue to follow this issue and to broaden dialogue between nonprofits and small businesses, wherever possible.

Again, thank you very much for joining us and helping to make the meeting a success.

Sincerely,

Judy Pope

Judy Pope
Assistant Director

JP:jh

uwı

United Way of California
410 Bush St., San Francisco, California 94108 • Phone (415) 772-4300

September 15, 1986

Alice J. Gallagher
Beltone Hearing Aid Center
1736 Telegraph Avenue
Oakland, CA 94612

Dear Ms. Gallagher:

Thank you for agreeing to serve on a panel at our meeting to discuss relations between small businesses and nonprofits. The meeting will be held:

Thursday, October 9, 1986
10:00 a.m. to 12:00
United Way of the Bay Area
410 Bush Street, Conference Room 2
San Francisco, CA 94108

The purpose of the meeting is to begin to explore areas of concern for both small business owners and nonprofit agencies. This will be a preliminary discussion which will help educate the staff of the United Way of California and local United Way organizations about the problems both nonprofits and small businesses are facing in today's changing economic and charitable climate.

The meeting got a little bigger than I anticipated - there is already great interest in this topic. In order to get the best use out of our time, I have structured the meeting to open with two panels. One panel will consist of small business representatives, the other of nonprofit agency staff. Each panelist will have a few minutes to describe the experiences which have caused his or her concern about emerging problems between small businesses and nonprofits. After the panels there will be ample time for general discussion.

We hope to begin a dialogue to develop strategies and solutions which do not impair the charitable activities of nonprofit agencies.

Although the list of attendees has not yet been finalized, the

UW2

following people have been invited and have expressed interest:

William R. Barrett
Executive Director Easter Seal Society of California

Gene Penne
CA-Chairman Chamber of Commerce Small Business Committee

Glenn Austed
Regional Director Family Services of America

William Sirak
President Northern Rocky Mountain Easter Seal Society

Jerry Desmond
Small Business Lobbyist

Other participants will include staff from the United Way of California, United Way of the Bay Area, United Way of Los Angeles, United Way of Santa Clara County, United Way of Orange County, and United Way of the Sacramento Area.

I have enclosed some materials for your information which might help prepare you for the discussion. The background paper was prepared by the United Way of America.

I would appreciate confirmation of your participation as soon as possible, using the enclosed card. I'm looking forward to meeting with you.

Sincerely,

Judy Pope

Judy Pope
Assistant Director

20 people from United Way.

Alexandria
Pat Barrett.

JP:jh
Enclosures
(NP-NS)13

UW3

United Way of California
410 Bush St., San Francisco, California 94108 • Phone (415) 772-4300

SMALL BUSINESS/NONPROFITS RELATIONS MEETING

Thursday, October 9, 1986
10:00 a.m. - 12:00 noon
410 Bush Street, Conference Room 3
San Francisco, CA 94108

AGENDA

I.	Introductions	
II.	Welcome	Herbert J. Paine
III.	United Way of America and the White House Conference on Small Business	Patricia R. Barrett
IV.	Panel Discussions	
	A. Small Business Panel	Richard Blattner Alice J. Gallagher Ralph Risley Mervyn Silberberg
	B. Nonprofit Panel	Glen Austed Ben Lindekugel William Sirak
V.	Questions and General Discussion	

10/8/86

SERVING CALIFORNIA UNITED WAYS, CRUSADES, FUNDS AND PLANNING COUNCILS

C-429

uw4

SMALL BUSINESS/NONPROFITS RELATIONS MEETING

Thursday, October 9, 1986

ROSTER

Small Business Panel

Richard Blattner - Vice President, Charles Evans & Associates
Alice J. Gallagher - Beltone Hearing Aid Center
Ralph Risley - President, CUMA International
Mervyn Silberberg - San Franciscans for Neighborhood Enterprise

Nonprofit Panel

Glen Austed - Regional Director, Family Services of America
Ben Lindekugel - Director of Community Affairs, United Way of King County, Seattle
William Sirak - President, Northern Rocky Mountain Easter Seal Society

Audience

Patricia R. Barrett - Vice President Government Relations, United Way of America
William R. Barrett - Executive Director, Easter Seal Society of California
Kathy Deamer - Manager, Office of Research & Policy Analysis, United Way of the Bay Area
John DeHoney - California State Chamber of Commerce
William George - Chief Counsel for the Assembly Committee of Finance and Insurance
Greg Goggin - Director of Government Relations, United Way of Orange County
Joanne Gribble - Director of Marketing & Communications, United Way Sacramento Area
Eleanor Hawkins - Director, Allocations and Agency Relations, United Way, Inc., Los Angeles
Jack Healy - Associate Executive Director, New Business Development, United Way of the Bay Area
Nancy Howe - Director, Planning & Allocations, United Way of Santa Clara County
Robert Lane - Volunteer, Co-Chair, Subcommittee on Small Business, United Way, Inc., Los Angeles
Pat Parsell - Director, Government Relations, United Way of Santa Clara County
Jim Schwaninger - Group Vice President, United Way of America

United Way of California

John B. M. Place, Chairman of the Board
Herbert J. Paine, Executive Director
Judy Pope, Assistant Director

uw5

SMALL BUSINESS/NONPROFIT COMPETITION

I. HISTORY OF SMALL BUSINESS CONCERNS

Small Business Administration (SBA) Report

- ✱ In 1983 the Small Business Administration's (SBA) Office of Advocacy held a "Symposium on Nonprofit Competition with Small Business." Participants included representatives from SBA, small business, trade associations, academia, and congressional committees. No nonprofit organizations participated. A list of participants is in Appendix A. Following the symposium, the SBA published a report, "Unfair Competition by Nonprofit Organizations with Small Business: An Issue for the 1980s." SBA expanded and updated this report slightly in November, 1983 and June, 1984. → next page

- The SBA report contends that unfair competition consists of the following elements:

  - The nonprofit sector is growing explosively and deriving an increasing proportion of its income from "commercial" activities.

  - "Commercial activities" are not defined overtly, but the connotation is that any sale of goods or services is commercial whether or not it is related to the nonprofit organization's charitable purpose.

  - Tax exempt organizations use this government subsidy to compete unfairly with tax-paying small businesses in commercial activities.

  - Other government benefits such as exemption from Social Security and unemployment taxes and bulk mailing subsidies also enable nonprofits to compete unfairly. (Note: This statement is inaccurate. Nonprofits are not exempt from Social Security.

  - This problem is part of the larger problem of government competition with the for-profit sector. Tax exemption to nonprofits is an indirect form of government competition. (Note: Small business has been pressing government to contract for services from business whenever possible instead of providing service directly or contracting with nonprofit organizations.)

  - Service areas noted in the SBA report as having generated complaints of competition include:

    - Day care,
    - Nursing home care,
    - Recreation,
    - Travel and tourism

UW6

    - ° Audio/visual services,
    - ° Computer software
    - ° Health aids and pharmaceuticals
    - ° Research laboratories

  - "Traditional charities" and their work are not characterized as part of the problem, but traditional charities are defined as "donative," that is deriving support only from contributions and serving an economically disadvantaged population.

- ° Recommendations for correcting this problem include public policies to:

  - Prohibit or tighten restrictions income-generating activities not related to a nonprofit organization's charitable purpose. (At present such activities are permitted as long as they do not represent a "substantial portion" of a nonprofit organization's income, and tax is paid on the income generated.)

  - Redefinition of what constitutes a nonprofit organization and reassessment of criteria for chartering nonprofits to eliminate those that compete with for-profit organizations.

  - Prohibition on use of government-funded equipment for "commercial" activities (i.e. Any use that generates fees or other revenues.)

  - Equalization of nonprofit and for-profit bids for government contracts by requiring that nonprofit contract bids be increased by an equalization factor representing the proportion of income that small businesses pay in taxes. Proposed formulas range from 1%-10%.

- ° These recommendations would severely curtail the activities of any nonprofit health and human service agency that charges fees for service.

SBA Statistical Profile of the Nonprofit Sector

- ° In 1985, SBA published a brief statistical profile of the nonprofit sector based on Internal Revenue Service (IRS) data from 990 & 990T, reporting nonprofit income. SBA's profile purports to document the growth of nonprofit involvement in so-called commercial activities.

- ° The profile asserts that since 1975:

  - The number of nonprofits doubled.

  - Nonprofit income has nearly tripled.

  - Nonprofit share of GNP has grown from 7.4% to 9.5%, and reached a high of 11% in 1978.

  - Nonprofits are relying on sales for a disproportionate share of income (65.2% in 1975 to 76.3% in 1983).

→ next page

- * The IRS data are unreliable and misleading because of faulty data input. The National Center for Charitable Statistics at Independent Sector pressed the IRS for a retraction of the nonprofit data and for the IRS, in turn, to press SBA to retract its nonprofit profile. IRS agreed, but the SBA has refused to withdraw its profile. The matter has not yet been resolved.

Business Coalition for Fair Competition

- The Business Coalition for Fair Competition was formed in 1983 to educate the public on unfair competition and propose solutions. It represents several small business trade associations. (See attached list.)

- In July, 1985 the Coalition held a press conference to launch a publication called "Unfair Competition in the States," which recommends state policies to curb government and nonprofit competition with small business.

- "Unfair Competition in the States" This publication uses SBA's discredited "Statistical Profile of the Nonprofit Sector" to document the alleged growth of nonprofit competition and makes recommendations for state action to:

  - Prohibit use of state funds for either services or grants or contracts with nonprofit organizations to provide goods or services in competition with businesses and to prohibit local governments to use state funds or property in the same manner.

  - Prohibit grant or contract announcements that do not permit for-profit firms to apply.

  - Prohibit use of state-funded research equipment for "commercial" activities.

  - Require nonprofit organizations with for-profit subsidiaries to practice "maximum separation" by using separate facilities, equipment and staff, as well as separate financial systems to ensure that the for-profit subsidiary does not benefit from the nonprofit's status.

  - On business income unrelated to a nonprofit's charitable purpose: (1) Tax unrelated business income in states which do not now do it; (2) tighten definitions of activities related to the charitable purpose so that more activities are taxable; (3) tax unreported unrelated business income at the highest corporate tax rate rather than at normal rates regardless of whether the oversight was intentional; (4) limit unrelated business income to a specified percentage of income.

  - Apply the tax equalization factor to nonprofit bids for state contracts. (See SBA report recommendations.)

  - Require revenue offices to gather data on nonprofit sales revenues and taxes paid.

uw8

- Establish state commissions to: (1) investigate complaints of unfair competition by nonprofit organizations; (2) reassess criteria for chartering nonprofit organizations; and (3) hold hearings on unfair competition and make legislative recommendations.

° These recommendations also address the issue with too broad a brush and would result in elimination of tax exempt status and the ability to seek government funds for most nonprofit health and human service agencies.

White House Conference on Small Business

° A White House Conference on Small Business is scheduled for August 17-21, 1986. Nonprofit competition will be one of the focal points of this conference. This will build momentum for federal and state action.

° Preliminary meetings have been held in each state to elect delegates to the White House Conference and formulate resolutions for the Conference's consideration. Nonprofit competition has been discussed at each of these. These meetings have built momentum for state action and have generated publicity on the competition issue.

State Action

° The Pennsylvania legislature recently established a Select Commission on Unfair Competition to study this problem and recommend legislation. The Commission held a hearing at which United Way of Pennsylvania testified.

° New York State Senator Floss introduced a package of legislation based on the model legislation that the Business Coalition for Fair Competition proposed. Hearings were held, and United Way of New York State testified.

Local Action

° In 1985 a tax assessor in Multnomah Co., Oregon (Portland), responding to a complaint by the International Racquet Ball Association, withdrew the YMCA's property tax exemption retroactively and charged the "Y" over $1 million in back taxes. The tax examiner determined that the Y should not have been given the exemption because relatively little of its income was derived from charitable contributions, but rather from fees for service, memberships and government grants and contracts. The tax examiner followed a "donative" view of the voluntary sector in using the scope of charitable contributions as the measuring stick for tax exemption.

° A tax examiner in Illinois made a similar ruling on the YMCA.

° A Kansas Court struck down tax exemption for nonprofit organizations that charge fees for services. A coalition of nonprofit organizations won legislation to overturn the Court's ruling.

uw9

- Although two of these situations involved the YMCA, voluntary sector leaders in these states expect these counties to apply the new rulings to other nonprofit agencies.

- These incidents point out ambiguities in state laws governing tax exemption. The states formulate laws for obtaining exemption, and local property tax officials determine which organizations meet the requirements of the law. State law on charitable organizations is not consistent with federal law. Nonprofit agencies in more states may be vulnerable to a strict interpretation of the law, although traditionally they have been regarded as charities.

Small Business Set-Asides

- Since 1985, vigorous enforcement of the small business set-aside program by SBA resulted in some nonprofits losing government contracts. The federal set-aside law requires that a specified percentage of each department's contracts be set aside for small businesses only to apply.

- Because most health and human service contracts are small, there is a tendency to select these for set-asides. Voluntary agencies fear that all such contracts will be set-aside, and they will be foreclosed from the opportunity to compete for these contracts.

- This situation has principally affected family service agencies providing employee assistance programs to federal agencies.

- If strong set-aside laws were present and vigorously enforced at the state level, many of the human service contracts now going to voluntary agencies could be lost. They are all relatively small contracts, and contracts tend to be set aside based on size.

II. ROOTS OF THE PROBLEM

- The service sector of the economy has been growing. Businesses in large numbers are entering fields that formerly were dominated by the voluntary sector. Some examples include:

  - Day care centers

  - Substance abuse treatment

  - Fitness and recreation

  - Family counseling

  - Health care, including home health, nursing homes, hospitals and health clinics

UW10

- In the past, nonprofit and for-profit firms existed side by side in many of these fields, but they served a very different clientele. For-profit firms or independent professionals served the wealthy, while nonprofits served the poor and working classes.

- Nonprofits and for-profits are now sometimes competing for the same clientele--the middle class. This phenomenon is occurring because:

    - Nonprofit services have evolved over time as the sector attempted to respond to major social upheavals and human distress, and to shifts in governmental roles and responsibilities.

    - Nonprofit services helped waves of immigrants to assimilate to this culture and rural workers to adapt to urban life during the industrial revolution. The sector continued to serve these groups as they moved into the middle class because these groups expected to continue to support the availability of nonprofit services.

    - Government took on more and more responsibility for the basic needs of the poor and disadvantaged during the Depression and the Great Society era. Nonprofits, consequently, turned their attention to personal and social problems caused by an increasingly complex society and affecting people from all walks of life--not just the destitute.

    - By the 1980's, however, widespread public acceptance of the need for human services led to the development of a commercial market for many human services. A broad base of consumers are willing to pay the full cost of those services from for-profit firms. This has led for-profit firms to enter these markets.

    - In addition, government funding has created a commercial market for health and human services to the poor through third party payments.

- At the same time, nonprofits are increasingly engaging in business enterprises both related and unrelated to their charitable purposes. Enterprise in the Nonprofit Sector, a 1983 study of 130 organizations with 501(c)(3) status by James C. Cummings and Mary Keil and published by Partners for Livable Places and The Rockefeller Fund reports that:

    - 60% of the nonprofits studied generated revenues from enterprises, and 69% of these activities were begun since 1970.

    - 22% of the nonprofits studied earned over 10% of their incomes from these activities.

- The same report traced the history of nonprofit enterprise and noted:

    - Nonprofit enterprises are as old as church bazaars.

uw11

- Groups pioneering a high level of business enterprise were those serving people that couldn't win broad-based public sympathy and support (i.e., ex-convicts, the mentally ill, drug and alcohol abusers).

- The establishment of community development corporations in the 1960's set the pace for nonprofit enterprises in antipoverty programs.

- The Great Society's ambitious social agenda led many nonprofits to seek new sources of income to expand their programs and meet newly identified needs.

- In the 1970's increased emphasis on professionalism in nonprofit management led managers to put idle equipment and facilities to use in business enterprises when not in use for charitable purposes.

- The federal funding cuts of the 1980's, estimated by the Urban Institute at over $20 billion, led nonprofits to seek replacement funds.

III. NONPROFIT HEALTH AND HUMAN SERVICE CONCERNS

° Nonprofit health and human service agencies are concerned by the entry of for-profit firms into health and human services and the complaints of unfair competition with small business.

  - The proposals to correct "unfair competition" are draconian and could eliminate charitable tax-exempt status for most nonprofit health and human service agencies. Most agencies can be characterized as competing with for-profits because they charge some fees, although usually token amounts or based on ability to pay; and for-profits operate in the same service fields.

  - The quality of services may be sacrificed to earn a profit.

  - For-profits cannot ensure an equitable distribution of services to all who need them, but may serve the paying clients with relatively manageable needs, driving nonprofits out of the market, and leaving major gaps in services.

  - The health and human service system may become inequitable as a two-tiered system develops--one for the middle class and one for the poor.

  - Nonprofits will end up serving only the poorest people with the most difficult and expensive problems to treat and no counter-balancing clients from the middle class which have given nonprofits the stable financial base with which to serve the poor.

  - For-profit firms lack the community involvement in services and accountability that nonprofits provide through volunteer particiption on governing boards and in service delivery.

UW12

- Both government and business encouraged and exhorted nonprofits to become more enterprising and self sufficient, and now these groups may pull the rug out from under the nonprofits' newly established revenue sources.
- Nonprofits will be unable to find new sources of income to replace lost government funding.
- Nonprofits developed many services for needs that were not being widely addressed, and they are reluctant to abandon services around which they have developed great expertise and credibility.
- Nonprofits fear that the concept of voluntarism will be diminished.
- For profit firms may divert most government grants and contracts from nonprofits through set-asides and low bidding, taking away from nonprofits another major source of support.

° Nonprofits are also concerned about their entry into business enterprises.

  - Establishing for-profit subsidiaries may divert nonprofits from their charitable missions and change the nature of nonprofit organizations.
  - Business enterprise activities may take time, resources and energy away from charitable services.

IV. SMALL BUSINESS CONCERNS

° The majority of small business complaints on nonprofit competition are with universities rather than nonprofit health and human services. However, some nonprofit health and human services are major concerns. For example, the YMCA is under fire from health and fitness clubs.

° Typically, small businesses are most concerned when a nonprofit organization begins to offer its services to the general public at a price which undercuts an existing small business and threatens the proprietor's livelihood.

° The concerns increase when the small business discovers that the nonprofit is not paying the "unrelated business income tax" on the proceeds of this enterprise or when the nonprofit organization's for-profit enterprise is benefitting from the nonprofit's resources.

° Some small businesses are raising a more philosophical issue. They are questioning whether some traditional charitable missions are still valid in 1986. This is the focus of the health clubs' complaints about the YMCA.

° Some examples that small business cites include:

UW13

- A university laboratory begins selling its services to private business in direct competition with existing laboratories and the for-profit center pays no rent or only token rent which enables the nonprofit to undercut the usual retail price.

- A university cafeteria begins to cater weddings and parties and does not pay the unrelated business income tax.

- A nonprofit health clinic which buys drugs at a special nonprofit discount rate from a private company and then dispenses them to the general public below the usual retail price without regard to ability to pay.

- A nonprofit day care center that opens in an area already served by a for-profit center and diverts most of the for-profit's clients because its prices are lower.

° Following are examples of human service activities that could pose problems for small business:

- A meals-on-wheels program that begins a catering service for the general public service as a revenue raiser.

- A food bank that begins a neighborhood grocery store open to the general public.

° The key elements of the problem are:

- Nonprofits moving in on a going for-profit concern.

- Nonprofits engaging in unfair pricing. This practice is not so much related to the benefits of tax exemption, per se, as the small business people contend, but it is caused by the practice of allowing the nonprofit entity to subsidize the cost of producing the for-profit product.

V. NONPROFIT RESPONSE TO THIS ISSUE

- The National Assembly, an umbrella organization for national voluntary health and human service organizations, of which United Way of America is a member, has published two reports:

  · "Competition between the Nonprofit and For-Profit Sectors" explores the philosophical and practical implications of the competition issue and begins to frame a voluntary sector response to the issue.

  · 'The Myth of Unfair Competition by Nonprofit Organizations," challenges the claim of small business advocates that tax exemption and other nonprofit benefits give nonprofits an unfair advantage by comparing the government benefits available to nonprofits and small businesses.

uw14

- The Grants and Contracts Project, a coalition of national voluntary health and human service agencies which United Way of America coordinates, has:
    - Discussed voluntary sector concerns about the issue and clarified the voluntary sector role with staff of House and Senate Small Business Committees, SBA Advocacy Office officials, and GAO officials conducting a study of unrelated business income.
    - Launched on ongoing dialogue with small business including the Business Coalition for Fair Competition, the U.S. Chamber of Commerce, the National Association of Child Care Management which represents for-profit child care centers.
    - As a result of these discussions, small business leaders have agreed to work with national agencies to narrow the scope of their proposals so as to address their problems without undercutting voluntary health and human services.
    - For their part, the national agencies agreed to promote compliance with the existing "unrelated business income tax" and inform and educate their affiliates on this law, as well as how to maintain the appropriate separation between nonprofit and for-profit activities.
    - Both groups agreed that they should work together through Independent Sector's National Center on Charitable Statistics to improve IRS data on nonprofit organizations.

VI. IMPLICATIONS FOR UNITED WAY

- Small business lobbying could result in the elimination or restriction of nonprofit tax exemption including (1) federal, state and local income taxes, (2) state sales taxes, and (3) local property taxes.
    - Public officials may begin to base eligibility for tax exemption on the proportion of a nonprofit's income derived from charitable contributions.
    - This could increase agency costs by thousands of dollars annually and strain United Way allocations. Payment of back taxes or penalties could create a fiscal emergency for an agency. (The YMCA in Portland, Oregon, is being assessed over $1 million in back taxes.)
    - Loss of tax exemption would erode the traditional support in public policy that the voluntary sector has enjoyed throughout this nation's history. This loss may diminish public understanding of the role and contribution of the voluntary sector to the public good and make it more difficult to generate charitable contributions and recruit volunteers.

UW15

- Public officials may redefine the legal definition of nonprofit organizations to eliminate eligibility for those engaged in so-called "commercial" activities.
- Conflict between small businesses and United Way supported agencies could damage United Ways' fund raising efforts with small business.
  - Small businesses may blame United Ways for actions of the agencies they support.
  - Publicity on the competition issue may erode small business support for charities generally.
- Small business complaints could restrict many workplace presence programs even though services are provided free of charge.
- Bad publicity on the competition issue may erode public support for charities and United Way.
  - Comparisons between for-profit and nonprofit activities may give the public the impression that charities are no different than businesses, and charitable contributions may decline.
  - The public may lose interest in volunteering as well.
- Some nonprofit health and human service agencies may be straying from their charitable purposes, or others may be clinging to traditional services that met a charitable purpose in the past but may not continue to fulfill a charitable purpose in the future. If nonprofit health and human services are not keeping pace with changing needs, public support and contributions will decline.

UW16

Notes of meeting October 9, 1986 My minutes
United Way of California 410 Bush Street San Francisco CA 94108
SMALL BUSINESS/NONPROFITS RELATIONS MEETING

This meeting was set up the Monday after the White House Conference for Small Business in Washington D. C. Judy Pope called me requesting that several of the delegates and some representatives get together, to start a dialogue about not-for-profits competing with for-profits in the commercial retail area. The invitation letter was worded slightly different than what Judy originally conveyed to me. The reading material attached to the invitation letter seemed on the defensive and not condusive to debate or truce.

It appears to me that not nearly enough "small business" people were represented, and I am not sure how many others were invited. I do know that Mr. Silberberg was asked to attended only after I sent my regrets to Judy, one week before the meeting. The Not-For-Profit representatives greatly outnumbered the For-Profit business people.

There were no ultimate conculsions to this meeting, and the staff people from Easter Seals and Family Servies of America made it very clear that they intended to continue their present commerical ventures, as well as, expanded into other areas where they feel there is need.

A copy of the meeting notes from United Way are attached--they are NOT A TRANSCRIPT as I had hoped. The reporter at the meeting was from Family Services not from United Way Agencies.

My notes from the meeting will add some to the notes from United Way.

The meeting was structured in a round table discussion fashion. The CONFERENCE ROOM (which was very modern) could have sat approximately 250 people. Coffee and danish were served---just to give an idea of how big the United way building is in San Francisco. The office space we have in San Francisco runs about $2.50 a sq ft (and our building is an OLD building. I also believe that the different Not For Profit Agency's paid for their representatives to be at this meeting---whereas you know who paid the way for the business people. The speakers were asked to be on panels The agenda shows which were SB people and which were NFP's.

Herb Paine, Executive Director of United Way of California and Judy Pope Assistant Director were the moderators. Ms. Patricia Barrett, Vice President of Government Relations United Way of America, spoke first She spoke about the meeting that Mr. Bill Armoney(spelling) and she attended with BCFC and stated that she thought it was a good productive meeting and that now UWA understood the problems that small business face and that the leaders of BCFC understood better the problems that UWA and other NFP's faced. She was in hopes that this would be the first of many meetings to be planned across the nations. That these meetings would bring a co-existance of the two and that we would hopefully not get to the "LEGISLATIVE ARENA".

RICHARD BLATTNER -background-Nuclear physicist)-President of Charles Evans Associates (a high-tech business in silicone valley) White House Delegate and is very active in unfair competition by the governemnt and quasi-government agencies.

uw17

Mr. Blattner cited several examples of unfair use of federal funds, equipment, books, computers, and research facilities for the purpose of selling products and services to the public. He had copies of advertisements from magazines and direct mailings that he received. The questions asked of Mr. Blattner were regarding taxation of the profits, not whether the profits were in direct competition.

Mr. Silberberg owns a business in San Francisco dealing with busness zoning in San Francisco. He was a delegate to the White House Conference and was on a member of Implementation Committee. He worked with me through the entire eight months, was very responsive, and helped out tremendously. I think what they wrote in their notes is accurate.

Mr. Risley- dont know from whince he comes.---however, he did give some background left out of the UWA notes. Says he had been an advocate of small business for years. His WIFE is on the Board of Directors of Family Services of America and on the Board for the United Way of the Bay Area. Because of his wifes involvement with the United Way he can understand why NOT FOR PROFITS go into competition---they must keep up their customer base in order to get funding----and to keep the customer base up or growing they must look for new customers. He doesn't believe that the agencies receiveing United Way money are flagerantly abusing the system. It's just like some of the organizations Lyons, Elks, Shriners, they could internally be misusing their funds---but he doesn't believe this is happening. He feels that the relationship between the UW and its agencies fill gaps for services that would otherwise be unfilled. The policy of UNITED WAY is to make sure that "any agency that receives allocations from UW move toward self-sufficiency. Each year the monies allocated are reviewed with each of the agencies to make sure they are moving toward that goal..

Mr. Glen Austed- Regional Director (and introduced himself as "Counsel" for) Family Servies of America. Obvious company man and said he'd just celebrated his 25th anniversary with them. He first gave a little synopsis of what Family Services was---said it is over 290 separate agencies which has 6,500,000 employees or volunteers. The services that the agencies provide has changed over the years with the changes of our society. The main problems THEY have had to deal with are Liability Insurance and the costs of services. They see problems where the diffinite not-for-profit and for-profit boundaries have become blurred and the not for profits no longer have the resources for incresed reviews---therfore they no longer have the contribution increases and have had to go into business to keep up with the growth,. It his feeling that the laws prohibiting government--quasi government--universities from infringing on small business was essentially set pu to protect small businesses from being taken over by large corporations. That the IRS 990 and 990T were disigned to take care of any small profit that a charitable organization would make. [He concluded with a a challenge to the small business community that if we would contribute more to the non-profits they would not be forced to compete with us.

The laws were designed to protect small business from lrg. corps. - Not the little bit of profit made by charities.

uw18

PAGE 3-

Oregon & Washington

Ben Lindekugel- Director of Community Affairs-United Way of King CountySeattle Started off telling everyone that the YMCA had lost it non-profit status in Portland not necessary becuase it was making a profit but becuase it is listed in its own IRS status as "Charater Building" and they seemed to be less that that. He went on to point out to the business people present that we should note what use the monies derived from profits are used for. They only fund agencies that help the truly needy and that it is a person social responsibility to volunteer for charities. He is the one who thought it might be a good idea to "spin-off" the for profit venture (company) after it was making too much profit.---Course this was a problem as far as using the money to set a business and having on the job training. ***....."if the for profit businesses continue to take away clientele then there isn't enough clients for everyone. Maybe we could work together on this problem."

Bill Sirak- President, Nothern Rocky Mountain Easter Seal Society- Started off stating directly to me that the Easter Seals had started to "sell" audiological, speech pathology, and hearing aids in Illinois Montana, Iowa Idaho, Colorado and a few other states. They of course have very qualified specialists--MA Audiologists to do the work. Mr. Sirak also serves on the Board of Directors of a hospital in Montata and they are selling oxygen. The reason they started to sell hearing aid is that the quality was so poor and the dispensers were so uncooperative. The Beltone dealer down the street would not refer patients back to Easter Seals for reevaluation. The Easter Seal Society had gone to the Hearing Aid Industry and asked for help but received no cooperation. He stated that everyone saw them enter the hearing aid market and said they did it to make a lost of money---Mr. Sirak assured us that this is not the case at all. He is not sure where this venture will go bigger or smaller but he said they will continue. He mentioned the Beltone Name three times as the example of the uncooperative dealer.. The notes taken by the secretary of UW are very inaccurate...they imply that the Easter Seals are not as of yet in the for-profit business and Mr. Sirak made it very clear that they were in the market...their advertisements prove that they are.---

John DeHoney; Chamer of Commerce California extremely well informed--defended the small business person and expressed that it was truly unfair for the no-for-profits to use their tax status avantage to promote their business ventures and to lure clients to their business with the intent of making a profit. He suggested that the two sides continue to talk and try resolve idividual issue areas and problems at local and government levels---if there is no dialogue continueing then the situation will only worsen.

The other people at this meeting were defensive in that they feel like the small business person has an unfair advantage over them with the public, IRS and legislature. That we have powerful PAC's that the not-for profit can not compete. They people were obviously devote buearucrats.

uw19

SMALL BUSINESS/NONPROFIT RELATIONS MEETING

October 9, 1986

NOTES

Re agenda item "United Way of America and the White House Conference on Small Business":

Pat Barrett -

Some of the work UWA has been doing with regard to small business/nonprofit: Visit with the President's Coalition for Small Business to open discussions regarding small business concerns - resulted in recognition of need for more discussion; meeting of agencies/small business, Chamber of Commerce Small Business Center; attended White House Conference to share United Way concerns - resulted in greater understanding between small business/nonprofits.

After White House Conference, UWA plans to continue meeting with small business representatives, stressing the importance of replicating these meetings at a local level.

Panel Discussion

Blattner - (Affilated with Association of Independent Laboratories) -

State and private universities are major competitors of small business; misuse of federal equipment in competing with Small Business.

Place -

Asked what the position of small business would be if nonprofits were willing to pay taxes on profitable enterprises; Answer: Richard Blattner cited a proposed allowance of for-profit ventures with "full cost accounting". Mr. Blattner felt this sort of accounting is judgmental, difficult, unwieldy.

Gallagher -

Feels the intent of nonprofits should be for the needy; charitable causes, but not for-profit. Cited Y's vs. health centers. Feels that nonprofits should be made to keep their for-profit ventures on a separate, equally-taxed basis. Any for-profit venture should be treated as a small business.

UW 20

Silberberg -

Has been delegate to the White House Conference. Feels there is a lot of business going on which is not necessarily for the benefit of the needy; feels strongly about the use of volunteers, tax-exempt status. Urges increased voluntarism; dedicated volunteers could increase donations, thereby making the additional fundraising unnecessary.

Risley -

Noted that he has been involved with small business for a number of years, but recognizes the needs of nonprofits through his wife's involvement with United Way.

Feels that lack of government involvement is partially to blame for the present situation; tax code is lacking in allowing profits to be hidden, allowing misuse of tax exempt status. Core issue is difficult to isolate.

Austed -

Noted blurred boundaries, i.e., area of government regulations, rules.

Nonprofits have had to become more businesslike because funding, contributions, etc., no longer meet the increasing needs. Results of an intensive study found that tax benefits to nonprofits are negligible. Advised small business panelists that nonprofits are required by IRS to submit a 990T form, indicating all profitable enterprises undertaken.

Lindekugel -

Small business should note what use is made of money derived from profitable activities.

Possibility of restructuring our culture to accommodate both interests.

In providing a nonprofit service, i.e., day care, should an agency consider spinning off as a for-profit when, using businesslike methods it begins to realize a profit from the service?

"Vision vs. market." The beginning of a solution is to continue meetings between small business/nonprofits at a local level to discuss issues as they arise.

uw21

Sirak -

Nonprofits attempt to supply products/services at an even cost level. Easter Seal has considered going into for "for-profit" ventures, turning profits back to the nonprofit agency.

Argument/Suggestions:

Silberberg:

More dollars should be spent providing services to the truly needy.

Gallagher: Remarked that the nonprofit statement that they are being forced into profitable ventures cannot be justified in any way by a so-called not-for-profit agency. Competition is proved by Silberberg's statement that Easter Seals has considered satelliting of for-profit ventures. Accuses nonprofits of using tax exempt status to obtain profit-making businesses.

Lindekugel: Again stressed the importance of both sides continuing to meet to come to terms on a local, individual basis.

Risley: "Why do charities chase the market" when it shifts? The boundary of the served market and the unserved market is constantly changing.

Austed: Pointed out that UWs in California gives proportionately less to agencies and encourages more individual fundraising enterprises than other states. Feels this is a California UW culture guided by volunteers rather than nonprofit professionals.

DeHoney: Feels the joint venture concept may have some merit. Both sides have valid concerns and areas of service. Encourages continuing dialogue to resolve issues at the local and university levels. Markets will continue to change, and without continuing dialogue the present competitive situation will worsen.

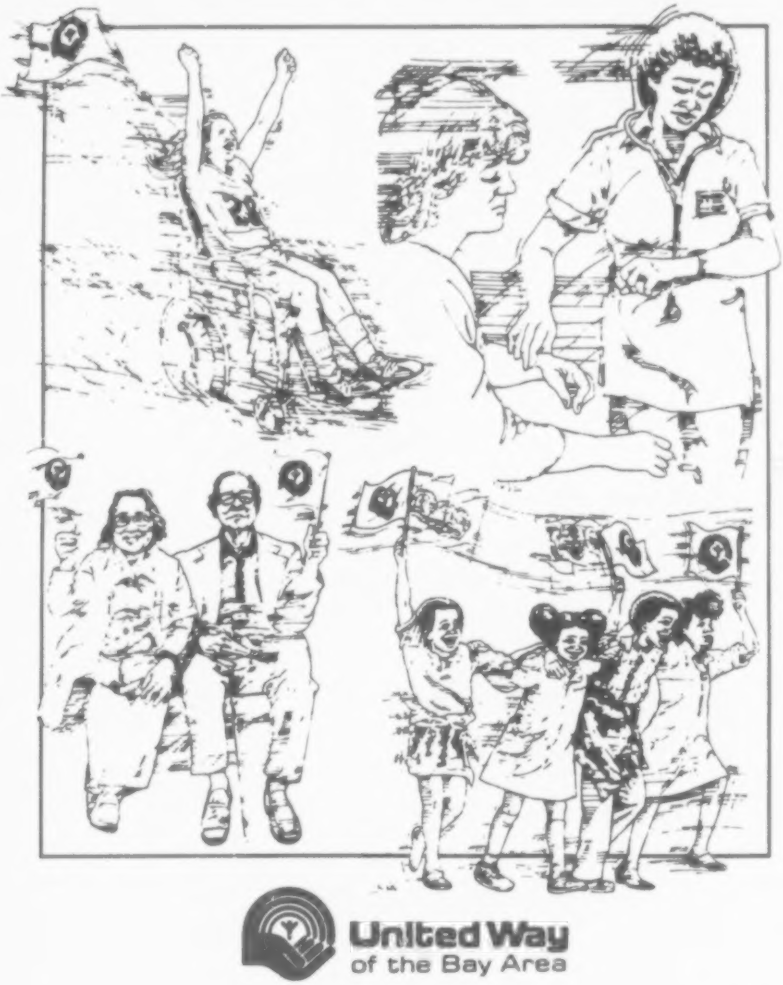
Pat Barrett: Also encourages ongoing dialogue, as well as providing information and education, and pinpointing local, individual issues.

Lane: Agrees with concept of joint ventures and continuing dialogue.

Risley: Suggested that when nonprofits are reviewing the possibility of entering a profitable enterprise, they address the possible impact on the small business sector.

UW22

1986-87
FACTS BOOK
& AGENCY DIRECTORY

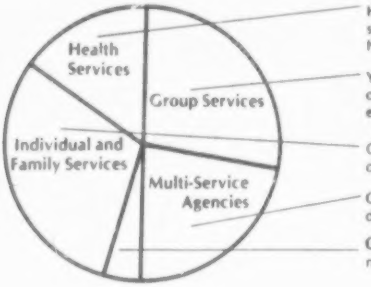


United Way
of the Bay Area

uw23

Where Do United Way Dollars Go?

The Need	How United Way Responds	
• Between 1986 and 1990 the percent of **persons aged 65** and over will increase 16%—the fastest growing segment of the population.	• Health clinics, in-home health care for the frail elderly, geriatric nursing, medical and dental services, transportation, meals for home-bound and social programs. • $2,435,000 in United Way support to 35 organizations in the Bay Area.	***health clinics, meals, transportation***
• **Family violence** is increasing at alarming rates: – Reported child abuse cases have increased 175% between 1980 and 1984. – 70% of all reported assault cases are a result of wife beating. – Elderly abuse is as yet undocumented, but estimates indicate a level comparable to that of child abuse.	• Short-term emergency "safe" shelters for victims of violence and sexual assault; food, clothing, transportation, health and mental health care counseling. • $2.5 million in United Way support this year.	***"safe" shelters, counseling***
• There are nearly 260,000 persons with **physical disabilities** in the Bay Area.	• United Way supports 15 agencies with more than $1.5 million for rehabilitation, therapy and counseling.	***rehabilitation***
• **Child care** needs have increased to the point where there are only enough licensed child care slots available for 60% of the children under nine who have working parents.	• United Way spends $5 million on child care, counseling, parenting skills and "latchkey" programs.	***daycare centers, "latchkey" programs***



Home health; clinics; services for developmentally, physically, emotionally handicapped; drug & alcoholism rehabilitation; mental health counseling.

Y's, scouting, neighborhood centers, youth clubs — offering individual development through recreational, educational, vocational and cultural approaches.

Counseling agencies, institutional care for emotionally disturbed and delinquent youth, day care.

Combining services in the areas of health, community development and planning, and family services.

Community Development and Planning —Housing, man- power training, volunteer placement and services.

uw24

Local Decisions By Local Volunteers

People—volunteers whose biggest gift is the generous donation of their time—are what keeps United Way growing as the Bay Area's most effective citizen-run, community-responsive organization. Locally based volunteers represent a true cross-section of the uniquely diverse Bay Area population—all walks of life, racial/ethnic and religious backgrounds. These volunteers make community planning and funding decisions that accurately reflect present and emerging community needs.

Choosing Where Your Gift Goes: You Have An Option

Through our **Donor Option Plan,** you can direct all or part of your United Way gift to a specific United Way agency, a qualifying human care agency, or another United Way of your choice. Last year, over 2,000 nonprofit (501 (c)3 tax-exempt) service agencies received contributions through the United Way Donor Option Plan.

Contributions Go Where They're Needed Most

The expertise offered by United Way's hundreds of volunteers helps maintain an outstanding cost effectiveness that keeps 90 cents of every donated dollar going directly to human services.

UNITED WAY'S COST EFFECTIVENESS
90% to Services

Only 10% for administrative and fund raising costs.

Agencies represent people—people being served by the more than **270** programs funded by United Way. Last year, nearly 2 million people (your family, friends, co-workers, neighbors and, perhaps, you) turned to United Way for help. Thanks to you, it was there, willing and ready in more ways than you're probably even aware.

Meeting Your Needs

For 64 years, United Way of the Bay Area has been there when you needed it.

As responsive as United Way and its agencies are to community needs, the demand for human services is continually growing, offering a formidable challenge to the community's ability to respond.

uw25

You and United Way—Pulling Together to Make the Difference in Our Community

The Difference Is You

Through the many and varied faces of United Way, you join with your neighbors to help one another. By your generous support you respond to real human care needs, and you become the hope for the future of many. Your investment in United Way touches the lives of thousands. You make the difference in our community.

How To Use This Directory

This Agency Directory is intended to be "user friendly". It features:

First: General information about United Way and how it works in the community (pages i to vi).

Second: An index listing all United Way funded agencies (pages vii to xvii), presenting these organizations alphabetically under the county in which they offer their services, and within each county, under the category of the service which that agency offers (e.g.children/youth, mental health, etc). Page numbers following each entry indicate where the full agency profile is found in the body of the Directory.

Third: (on pages 1 to 38), a Bay Area-wide alphabetical listing of all the United Way agencies which your contributions support, complete with agency addresses, telephone numbers, branches and a brief description of the services offered. United Way funding figures reflect allocations and donor designated dollars for FY '87. Agency budget figures are estimated for FY '87.

What United Way Is All About

Like the Bay Area community it serves, the United Way here has grown and adapted dramatically in its 64 years. It's grown from rock solid beginnings as the many Community Chests, on to the United Bay Area Crusade of the 1950's, to finally become what it is today—the driving catalytic force through which dedicated volunteers, concerned businesses, organized labor, government agencies, people-helping services and contributors like you pull together to unite in the pursuit of community interests.

People Helping People

It's through the agencies listed in this Directory that United Way helps communities to solve their problems. These people-helping organizations are able to continue meeting community needs because of the generosity of United Way's half-a-million contributors—people at their workplace, local businesses/organizations, and individuals from their homes—who share in building better neighborhoods and communities.

uw26

Alphabetical Listing of United Way Agencies

A

A Safe Place*

P.O. Box 275 444-7255
Oakland 94604
Total Budget: $240,000 United Way Funding: $30,551

Provides a 24-hour crisis and information line, plus an emergency shelter for 20 battered women and their children. Shelter offers a 2-month stay during which women and their children receive basic necessities and support services. The goal is to help eliminate the cycle of physical or psychological violence within the family.

Alameda Boys Club

(See Boys Club of Alameda)

Alameda Family Service Agency

746 Eagle 521-4151
Alameda 94501
Total Budget: $221,376 United Way Funding: $58,169

Provides counseling and therapy services treating a wide variety of family and personal difficulties. Offers groups and educational programs.

Alameda Girls Club, Inc.

(See Girls Club of Alameda)

Allied Fellowship Service

1851 10th Avenue Administration: 534-5354
Oakland 94606 Counseling Program: 534-1986
Total Budget: $186,964 United Way Funding: $48,003

A halfway house for ex-offenders, parolees and probationers, offering help with job-hunting and personal readjustment.

Alta Bates—Herrick Rehabilitation Center

2001 Dwight Way 540-4411
Berkely 94704
Total Budget: $387,604 United Way Funding: $88,845

Provides children and adults with evaluation and treatment of communicative disorders. Pre-school language program provides individual and group therapy for children aged two and one-half to five years. Provides comprehensive physical and medical services to the physically and developmentally disabled.

American Cancer Society

California Division, Inc. 893-7900
1710 Webster Street
Oakland, CA 94612
Total Budget: $2,270,000[1] United Way Funding: $1,220,260

Provides services for cancer patients and their families. Works with the community to provide life-saving education programs and information on cancer prevention, detection and treatment for the general public and health professions. Funds research on the disease.

Local Units

Alameda County Unit — 3100 Summit, 5th Floor • Oakland 94609	832-7012
Contra Costa County Unit 1855 Olympic Blvd. Suite 100 • Walnut Creek 94596	934-7640
Marin County Unit 18 Mary Street • San Rafael 94901	454-8464
San Francisco County Unit 545 Post Street • San Francisco 94102	673-7979
San Mateo County Unit 1860 El Camino Real, Suite 301 • Burlingame 94010	697-1300

American Heart Association

California Affiliate 342-5522
805 Burlway Road
Burlingame 94010
Total Budget: $3,542,801[1] United Way Funding: $985,952

Provides educational materials about heart disease and stroke—prevention, treatment and rehabilitation. Local chapters sponsor educational and support programs for such groups as: heart patients, stroke survivors and parents of children with congenital heart defects. Offers heart disease prevention programs for schools and businesses. Funds research relating to diseases of the heart and blood vessels.

Also operates the Mended Hearts Program.

---

[1] Only FY86 figures available at printing

*Non-member grant agency

uw27

Community Child Care Coordinating Council of Alameda County

22430 Foothill Blvd. Suite A 582-2182
Hayward 94541
Total Budget: $2,057,606 United Way Funding: $54,470

Provides information and referrals to parents seeking child care and related services; technical assistance to individuals and groups on licensing, child care services, employer sponsored child care; nutrition education and training to parents and childcare providers; sponsors child care food program; administers child care vendor programs; administrates child care centers.

Community Education Center, Inc.

2600 Middlefield Road
P.O. Box 5382 364-7340
Redwood City 94063
Total Budget: $151,624 United Way Funding: $71,954

Provides a bilingual multicultural pre-school program for four-year old children from primarily low-income, Spanish-speaking families.

Community Food Coalition

5121 Port Chicago Highway 676-7543
Concord 94520
Total Budget: $533,909 United Way Funding: $52,563

Provides food to charitable agencies which feed and serve needy and elderly residents throughout Contra Costa County. Donations of surplus and salvageable food are solicited from farmers, packers, processors, manufacturers, distributors, and retailers.

Also operates Project Glean.

Community Health Center of Marin

2398 Sir Francis Drake Boulevard 457-7700
Fairfax 94930
Total Budget: $157,387 United Way Funding: $73,340

Offers general medical and gynecological services in its six weekly low cost evening clinics. The clinics are staffed by a core of volunteer medical professionals and community members who work in concert with the staff family nurse practitioner and registered nurse. Health education, information, and referral services are also provided by agency staff.

Clinic Locations

Fairfax Clinic
Fairfax Community Church
2398 Sir Francis Drake Boulevard • Fairfax 94930 457-7700

Marin City Clinic
Marin City Fire Department
850 Drake Avenue • Marin City 94965 457-7700

Mill Valley Clinic
Mill Valley Church of Our Savior
10 Old Mill Road • Mill Valley 94941 457-7700

Novato Clinic
Novato Human Needs Center
1907 Novato Boulevard • Novato 94947 457-7700

San Rafael Clinic
County Health Department
920 Grand Avenue • San Rafael 94901 457-7700

Community Music Center

544 Capp Street 647-6015
San Francisco 94110
Total Budget: $545,620 United Way Funding: $47,714

Provides music lessons for people of all ages and backgrounds offering programs in the full range of musical styles for instrument and voice. The agency's only entrance requirement is the student's interest in learning.

Branch Office

241—30th Avenue • San Francisco 94121 221-4515

Community Resources for Independent Living*

439 "A" Street 881-5743
Hayward 94541
Total Budget: $279,675 United Way Funding: $12,407

An independent living center for people with disabilities living in Southern Alameda County. Services provided include employment, housing and benefits counseling; independent living skills training; advocacy and outreach; information and referral; peer counseling and support groups.

Community United Against Violence, Inc. (CUAV)*

514 Castro Street 864-3112
San Francisco 94114
Total Budget: $180,619 United Way Funding: $19,200

Provides services to victims of violence while at the same time developing strategies to prevent such violence. Target population is the San Francisco Gay and Lesbian community.

*Non-member grant agency

uw28

Easter Seal Society of Marin*

70 Skyview Terrace 472-3170
San Rafael 94903
Total Budget: $220,405 United Way Funding: $4,319

United Way funds help to integrate disabled girls into girl scouting programs.

Eden Express*

799 "B" Street 886-8765
Hayward 94541
Total Budget: $450,000 United Way Funding: $20,000

Assists the mentally disabled to re-enter the community as independently functioning adults by gaining confidence and job skills in a real work setting. Programs address work adjustment, job skill training, vocational planning and job search.

Eden Youth Center

680 West Tennyson 887-1146
Hayward 94544
Total Budget: $177,029 United Way Funding: $34,452

The Center houses 15 agencies providing youth services in southern Alameda County, including health, mental health, counseling, teen groups, substance abuse, childcare and infantcare, tutoring, special education, recreation, and legal programs. The Center Office coordinates programs and advocates widely for supporting South County programs.

Emergency Services Network*

1212 Broadway, 15th Floor 451-3132
Oakland 94612
Total Budget: $65,000 United Way Funding: $17,756

A coalition of over seventy-five individuals and organizations which provide emergency shelter, food, information & referral, and supportive services for the homeless.

Emergency Shelter Program, Inc.

22634 Second Street, #205 581-5626
Hayward 94541 Crisis Line: 786-1246
Total Budget: $408,620 United Way Funding: $126,830

Provides emergency housing for a seven to 30-day period, meals, counseling/referral, licensed child care and job training assistance. Serves women and children (males up to 12 years of age) who are in crisis and are homeless. Professionally staffs a 24-hour crisis line: 786-1246.

F

Fairfax-San Anselmo Children's Center

199 Porteous Avenue 454-1811
Fairfax 94930
Total Budget: $652,980 United Way Funding: $46,265

Provides child care to 115 children ranging from infancy through 3rd grade from low and moderate income families. Support services that are integrated are: care of mildly ill children, mainstreaming special needs children, transportation for school-aged children, extended early and late hours, mental health consultation and comprehensive parent services, including respite care, classes, workshops and family events.

Family Counseling & Community Services

110 Petticoat Lane 937-8311
Walnut Creek 94596
Total Budget: $1,280,472 United Way Funding: $141,131

Provides a wide range of support services to individuals of all ages. Services include: Long Term Care, Family Counseling Center, Meals on Wheels, Friendly Visitors, Home Chore, Nutrition Project for the Elderly, and Case Management for the Developmentally Disabled.

Family Service of the East Bay

445 30th Street 834-5433
Oakland 94609
Total Budget: $604,330 United Way Funding: $298,703

Provides counseling, preventive and advocacy services as well as group therapy for a variety of family and personal difficulties, marital problems, parent-child relationships (including the direct treatment of children) and environmental problems. In the fall of 1986 child care services and a child care provider training will be initiated.

Branch Offices:

4537 Mattos Drive • Fremont 94536	791-3322
24301 Southland Drive B-6 • Hayward 94545	887-1843
2208 San Leandro Blvd • San Leandro 94577	483-6715
11740 Dublin Boulevard • Dublin 94568	447-5031
3311 Pacific Avenue • Livermore 94550	373-9005

---

*Non-member grant agency

uw29

Family Stress Center

200 "A" Harriet Drive 827-0212
Pleasant Hill 94523
Total Budget: $556,379 United Way Funding: $31,067

Provides therapeutic, supportive, and enrichment services to children and their families with the ultimate goal of preventing child abuse and neglect. Programs include: a center based counseling program; a respite nursery; the Child-Parent Enrichment Project, an in-home counseling program; Head Start preschool classes; the Adolescent Family Life Program for pregnant adolescents and mothers under the age of 18; parent education classes, and an information & referral service.

Family Service Agency of Marin County

1005 A Street, Suite 307 456-3853
San Rafael 94901
Total Budget: $507,279 United Way Funding: $119,086

Provides counseling services to individuals, couples and families. Divorce adjustment groups for children, family therapy, bi-lingual outreach counseling to Latino families, geriatric services, Child Sexual Abuse Treatment Program, "Senior Connection," a volunteer home visiting program for seniors.

Branch Office:

1907 Novato Boulevard • Novato 94947 456-3853

Family Service Agency of San Mateo County

1870 El Camino Real, #107 692-0555
Burlingame 94010
Total Budget: $2,124,399 United Way Funding: $182,870

Provides services for neglected, abused and sexually abused children. Operates infant and child care centers and a network of neighborhood day care homes. Also provides marriage, family, child and individual counseling. Operates a job training program for 100 low-income people over the age of 55. Also operates San Bruno Child Development Center.

Branch Offices:

190 Paloma • Pacifica 94044
35 Renato Court • Redwood City 94061
66 San Pedro Road • Daly City 94015

Family Service Agency of San Francisco

1010 Gough Street 474-7310
San Francisco 94109 Parental Stress: 441-KIDS
Total Budget: $6,152,061 United Way Funding: $444,684

Provides (through 11 sites) counseling services for families; child abuse prevention; counseling for Japanese, Chinese, teenaged parents and the handicapped; elderly services and geriatric outreach; nursing home ombudsman and foster grandparents; child care services for high-risk infants, teenaged parents and the working poor; mental health services for the chronically ill and the elderly; services for medically indigent adults. Also advocates for improved family life and self-sufficiency alternatives in community forums.

Local Agencies

Family Development Center
2730 Bryant Street • San Francisco 94110 282-1090

Teenage Pregnancy and Parenting Project (TAPP)
1325 Florida Street • San Francisco 94110 648-8810

Chinese Family Service
855 Sacramento Street • San Francisco 94109 982-3379

Long Term Care Ombudsman
916 Eddy Street • San Francisco 94109 474-7310
Phone Messages: 474-8757

Developmental Disability Services (GGRC)
1031 Franklin Street • San Francisco 94109 474-7310

Mental Health Geriatric Day Treatment Program
1111 O'Farrell Street • San Francisco 94109 441-1620

Balboa/San Miguel Infant Center
300 Seneca Avenue • San Francisco 94112 584-7274

Family Service Center
Naval Station Building 237 • Treasure Island 94130 765-5789

Army Community Services
Presidio Building 214 • San Francisco 561-5057

Filipinos for Affirmative Action/ Filipino Immigrant Services

310-8th Street #308 465-9876
Oakland 94607
Total Budget: $111,482 United Way Funding: $88,345

Assists immigrants in making adjustments to their new environments by providing employment counseling and job referral; immigration counseling for family reunification purposes; general information and referral; and community education.

Florence Crittenton Services

840 Broderick Street 567-2357
San Francisco 94115
Total Budget: $864,800 United Way Funding: $76,825

Residential treatment center for young, single, pregnant girls and single parents with infants under three years. Also operates an infant day care center (on-site) and neighborhood day care homes for young children throughout the city.

uw30

continued from previous page

(The) Bridgeway Project	441-8277
California Correctional Services	863-6520
Chinatown Corps	781-7360
Detoxification Services	626-2063
Emergency Disaster Services	Days 863-6520, ext. 35 Evenings 864-7000
Harbor Light Center	864-7000
Missing Persons Bureau	861-0755
Mission Corps	648-0260
Pinehurst Lodge-Women's Residence	695-8000
San Francisco Center for Social Services	861-0755
San Francisco Citadel Corps	431-4348
Senior Activities Center	777-2677
Senior Nutrition Program (18 sites)	777-2677
Silvercrest Residence	543-5381
Turk Street Center and Alcoholism Recovery Program	928-4120
Youth Services	431-4348
Service Extension Units	863-6520 Ext. 35

San Antonio Neighborhood Health Center

1030 East 14th Street — 834-8216
Oakland 94606
Total Budget: $842,254 — United Way Funding: $57,015

Provides a full range of family health services to residents of Oakland. Services include adult medicine, pediatrics, maternity services, family planning, social services, nutritional assessment, counseling, and services to the elderly. The Center serves primarily low-income Black, Hispanic, Asian and Eretrian residents.

San Francisco Bay Girl Scout Council Inc.

670 McCormick Street — 562-8470
San Leandro 94577
Total Budget: $2,618,000 — United Way Funding: $648,384

Serves girls predominantly under 20 years of age at hundreds of locations throughout the Bay Area and with camp sites throughout Northern California. Activities and leadership development for girls organized into small groups.

San Francisco Community Children's Nursery

1105 Quintara Street — 665-1880
San Francisco 94116
Total Budget: $379,811 — United Way Funding: $64,551

Provides day care services for pre-school children two and one-half to five years of age.

San Francisco Council of Churches— Social Services Department

942 Market Street, Room 408 — 433-4890
San Francisco 94102
Total Budget: $2,171,827 — United Way Funding: $68,215

Serves youth, children and their families; senior citizens; persons with disabilities; provides a community-based alternative to incarceration for women with children. Offers assistance via San Francisco Food Bank and Emergency Food Box; crisis intervention via Night Ministry; information & referral via Central Office.

Operates Healing Community, Elizabeth Fry Center, Grace Child Development Center, Saint Francis Meals Services, Noriega Senior Services, OMI Senior Center.

San Francisco Hearing and Speech Center

1234 Divisadero Street [illegible] medical — 921-7658
San Francisco 94115
Total Budget: $829,947 — United Way Funding: $90,562

Provides testing, rehabilitation, medical/legal evaluations, screening, counseling and habilitation to individuals with hearing and speech or language disorders.

San Francisco Senior Center

890 Beach Street — 775-1866
San Francisco 94109
Total Budget: $1,005,435 — United Way Funding: $166,667

Promotes the well-being of seniors by affirming their dignity, security and usefulness through a well-rounded program of social, recreational and educational opportunities to encourage friendly relationships, the development of individual skills and satisfying, independent social living. Serves as a community resource to the network of agencies working with seniors in the San Francisco area.

Branch Offices

Aquatic Park Branch
890 Beach Street • San Francisco 94109 — 775-1866

Downtown Branch
481 O'Farrell Street • San Francisco 94102 — 771-7950

Downtown Social Services
240 Jones Street • San Francisco 94102 — 441-8762

uw31

San Francisco Suicide Prevention, Inc.

3940 Geary Boulevard Business Phone: 752-4866
San Francisco 94118 Hotline: 221-1423
Total Budget: $330,481 United Way Funding: $67,009

Specially trained counselors provide crisis telephone counseling and information and referrals on a 24-hour, seven-days-a-week basis. Offers community and professional education through a speakers bureau. Also offers geriatric companionship to 5,000 seniors through Friendship Line. Offers a grief support group for friends and family of persons who have taken their life.

Drug Line:	752-3400
Mental Health Info & Referral Line (M-F; 9-5 only)	387-5100
TTY for the Hearing Impaired (Mental Health):	221-9174
Friendship Line for the Elderly:	752-3778

San Francisco Women's Centers/Women's Building*

3543 18th Street 431-1180
San Francisco 94110
Total Budget: $220,000 United Way Funding: $18,800

Develops a community environment that is supportive to women by providing a place for them to seek information, direction, and community involvement and by providing technical assistance and low cost office and meeting space.

San Leandro Girls Club

1245-147th St. 357-5515
San Leandro 94578
Total Budget: $431,176 United Way Funding: $124,577

Offer educational, vocational, and recreational programs through individual counseling, and group activities for girls and young women. Also provides family counseling for families and youth with problems. Extensive services provided to schools. Special outreach is directed to Hispanic girls and to pregnant teens/teen parents.

Branch Office

Eden Branch
680 W. Tennyson Road • Hayward 94544

San Pablo Salesian Boys Club

2851 Salesian Drive 233-2851
San Pablo 94806
Total Budget: $125,666 United Way Funding: $55,760

Volunteers provide one-to-one companionship with children six to sixteen years of age from single parent homes. Provides after-school program featuring all sports; tutorial help and independent living skills training for handicapped.

San Ramon Valley Community Center, Inc.

318 Diablo Road 837-8235
Danville 94526
Total Budget: $682,125 United Way Funding: $83,748

Provides multiple services to the residents of the San Ramon Valley, including counseling for troubled youth and their families, classes in personal growth and parenting; an information and referral service; support groups; support for the physically disabled; after school recreation for school age children; and a variety of educational classes for adults, youth and senior citizens.

Self-Help for the Elderly

640 Pine Street 982-9171
San Francisco 94108
Total Budget: $2,276,985 United Way Funding: $187,474

Provides a broad range of services for the elderly and low-income families. Services include case management, home-delivered and congregate meals, housing assistance, employment and training, skilled nursing and home health care and a community organizing program geared to improving the quality of life, independence and dignity of clients.

Services for Seniors, Inc.

1500 Laguna Street 922-5438
San Francisco 94115
Total Budget: $796,325 United Way Funding: $64,859

Provides hot low-cost meals at senior residences and centers and low-cost cold lunches (prepared by seniors) on weekends. Offers senior catering service and pilot vending machine project in selected hotels. Provides individual and group support service programs in low-income senior residences, and administers Friendship Center—a neighborhood drop-in center operated by seniors in the Tenderloin.

Service League of San Mateo County

878 Main Street 364-4664
Redwood City 94063
Total Budget: $289,081 United Way Funding: $80,397

Provides support and social services for county jail inmates, former inmates and families. Services include pre-release inter-

continued on next page

*Non-member grant agency

L

Women's Alcoholism Center*

3380 26th Street 282-8900
San Francisco 94110
Total Budget: $650,000 United Way Funding: $30,000

Advocates for, develops, operates and evaluates recovery services for alcoholic women, their children and those affected by alcoholism. Offers residential and non-residential alcohol services for women in early recovery and for children of alcoholics. Also educates and informs the Bay Area public about the effects of alcoholism.

Operates Pomeroy House.

Women's Institute for Mental Health*

264 Valencia Street 864-2364
San Francisco 94103
Total Budget: $345,764 United Way Funding: $15,890

Individual and couples psychotherapy on a sliding scale fee basis, primarily for women. Operates a drug/alcohol counseling program with special sensitivity to Lesbians (IRIS). Also offers counseling for incest survivors and occupational stress.

Y

Yook Yau Ji Ga Daycare

925 Stockton Street 397-1468
San Francisco 94108
Total Budget: $177,318 United Way Funding: $40,666

Provides quality bilingual-bicultural day care, by living out the meaning of its Chinese name: "Education and Love for Young Children in a Family Setting". The day care services 32 children between the ages of two and one-half to five years, five days-a-week, from 7:30 a.m. to 5:30 p.m., offering a hot lunch, breakfast and snack prepared on-site. The teachers have bilingual and professional education skills and work with children on a one to seven ratio.

Young Men's Christian Association—Bay Area Federation

220 Golden Gate Avenue 885-0460
San Francisco 94102
Total Budget: $20,753,527 United Way Funding: $1,191,593

Serves all ages through health programs, guidance and counseling, neighborhood and community development, camping, shelter for homeless and runaways, education, daycare and youth employment services. Distributes United Way funding to the following local agencies:

Local Agencies:

Berkeley-Albany YMCA

2001 Allston Way • Berkeley 94704 848-6800
Total Budget: $2,506,476 United Way Funding: $153,722

Locations:

921 Kains Avenue • Albany 94706	525-1130
2901 California Street • Berkeley 94703	843-4280
2009-10th Street • Berkeley 94710	848-9281
Camp Gualala • Annapolis 95412	(707) 886-5351

Metro YMCA of Alameda County

2101 Telegraph Avenue • Oakland 94612 451-8033
Total Budget: $2,536,346 United Way Funding: $229,850

Locations:

1612-45th Avenue • Oakland 94612	534-7441
951 Palisade Street • Hayward 94512	582-9614
41811 Blacow Road • Fremont 94538	657-5200
3265 Market Street • Oakland 94608	653-7818
10 West Neal Street • Pleasanton 94566	462-0270

Mount Diablo Region YMCA

Total Budget: $1,335,420 United Way Funding: $107,186

Corporate Office
1855 Olympic Blvd., Suite 101 • Walnut Creek 94596 935-9622

Mt. Diablo Family YMCA Branch
350 Civic Drive • Pleasant Hill 94523 687-8900

Walnut Creek YMCA
1855 Olympic Blvd., Suite 101 • Walnut Creek 94596 935-9622

San Ramon Valley YMCA
1855 Olympic Blvd., Suite 101 • Walnut Creek 94596 831-1100

The Mt. Diablo Region YMCA serves Contra Costa County with sixteen childcare facilities and ten program centers.

YMCA of San Francisco

220 Golden Gate Avenue 885-0460
San Francisco 94102 Program Information: 397-YMCA
Total Budget: $11,427,500 United Way Funding: $411,780

Locations:

855 Sacramento Street • San Francisco 94108	982-4412
166 The Embarcadero • San Francisco 94105	392-2191

continued on next page

---

*Non-member grant agency

uw33

United Way
of the Bay Area

Headquarters
410 Bush Street
San Francisco, CA 94108
772-4300

Alameda County Office
1212 Broadway, 15th Floor
Oakland, CA 94612
451-3132

Contra Costa County Office
1670 Concord Avenue—Suite 270
Concord, CA 94520
827-3530

Marin County Office
16 No. San Pedro Rd—Suite 115
San Rafael, CA 94903
492-9840

San Francisco County Office
Fox Plaza
1390 Market S.F.—Suite 201
772-4436

San Mateo County Office
205 West 20th Avenue
P.O. Box 5010
San Mateo, CA 94402
345-4871

United Way Information and Referral
772-HELP; 772-4357
TDD 772-4440 (Hearing Impaired)

Design by Art Plus

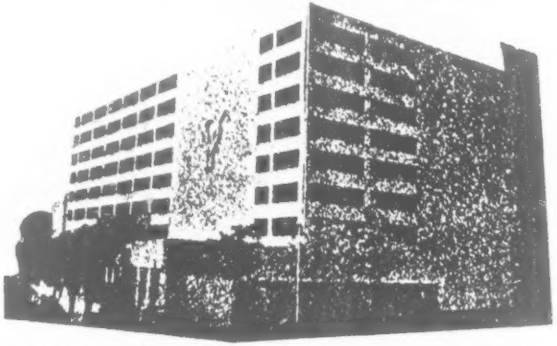
YMCA1

THE NEW OAKLAND Y

The new Oakland Y. There's something in it for everyone.

72,000 square feet
of exhilarating, fun-filled, action-packed space at 2350 Broadway.
Scheduled to open September, 1986

Charter memberships available now!



Swimming Pool: 25 meters 7 lanes 42' wide • 6 Handball/Racquetball Courts • 2 Squash Courts with glass back walls • Nautilus Weight Training Equipment • Keiser Pneumatic Weight Training Equipment • Aerobics Room—Life Cycles, Aerobicycles, Treadmills • Aerobic Exercise Area 40' x 40' • Jogging Track—11 laps per Mile with Pacing Lights • Multipurpose Gymnasium 80' x 100' • Whirlpools and Individual Lockers • Mens, Womens, Boys and Girls Locker Rooms • Saunas, Showers and Steam Rooms • Babysitting Room • Multipurpose Room

For more information, call: (Kim 451-YMCA)

NEW FEET ARE COMING TO OAKLAND
IT'S ALL HAPPENING AT THE Y

SUZANNE RUDISILL
Director of Marketing & Public Relations

YMCA of Alameda County
(415) 451-8033

2101 Telegraph Ave.
Oakland, CA 94612

THE NEW OAKLAND Y

PLEASE PRINT

SIGN-UP FEE

Name ________ (LAST) ________ (FIRST) ________ (MIDDLE)
Address ________
City ________ Zip ________
Phone (Home) ________ (Business) ________
Company Name ________
Address ________
☐ Tell me more ☐ My check's enclosed
☐ Bill me Amount: $ ________

Membership cost includes use of all facilities.

Corporate and Youth memberships are also available.
For more information call Kim — 451-YMCA.

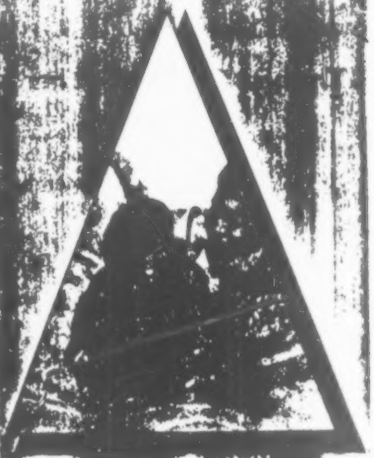
YMCA5

M is for Membership

Maternity Exercise Program (Pre- & Post-Natal)
Muscle Rehabilitation Programs
Martial Arts
Movement Education/Exploration
Modern Dance
Muscles in Motion
Magnificent Facilities
Myriad Activities

C is for Community

Child Development
Camping
Corporate Health Enhancement
Counseling (Health & Risk Factors)
Christian Values
Cardiac Rehabilitation
Community Activities & Development
Cardiovascular Exercise
Child Care
CPR



A is for Activities

Aquatic Safety & Swimming Lessons
Aerobic Dance
Aquacises
Adult Leagues
Aerobicycle & Lifecycle
Arts & Crafts
Athletics

Exhibit 3

This year nearly 2000 children, seniors and newcomers will come to the Central YMCA. They will come for friendship, exercise, fun, education, camp, sports, parties and help with personal problems. Nearly all are low income. Yet no one is turned away because of an inability to pay. But these programs do cost money.

HERE ARE SOME EXAMPLES OF WHAT MY GIFT WILL BUY:

$60	■ 8 karate classes for 15 children ■ 10 weeks of sports participation for a team of 10 children ■ 4 fitness classes for 20 senior citizens ■ One year's sponsorship for a senior
$120	■ 8 weeks of swimming classes for 10 children ■ A roof garden picnic for 35 seniors ■ 20 hours of English tutoring for a refugee child ■ One year's sponsorship for a youth
$200	■ 500 classroom hours for one adult in the Y's new English Literacy Program
$300	■ A week of summer school for 50 non English speaking children ■ A field trip out of the Tenderloin for 25 seniors ■ A month of weekly teen nights at the YMCA
$500	■ A weekend campout for 30 children ■ Information and referral services for 150 seniors
$600	■ One Annie, the human-like plastic model used to train hundreds of individuals annually in CPR classes and the YMCA's Cardiac Therapy Program
$1000	■ A week of summer camp for 15 seniors ■ A month of day camp for 40 children

WHAT'S THE BOTTOM LINE IN THE Y's COMMUNITY CAMPAIGN BUDGET?

The total branch budget is approximately $2.2 million. This includes all YMCA services: P.E., residence, facility use, English school, youth, family and seniors programs.

Of this total, $257,000 is needed to pay for the community programs serving youth and seniors. Also receiving funds will be our Cardiac Therapy Program and recently instituted English Literacy Program.

The challenge for our BE A HERO campaign is to raise $126,000 to support the people in these programs. It is a goal we must reach.

We are grateful to the United Way for their continuing support and we are presently challenged to raise matching funds. However, to maintain existing programs, we find that we must raise more money each year from our friends.

Support to Central Branch	1979	1980
United Way	$36,000	$41,000
Sustaining Campaign	**$33,000**	**$126,000**

The money raised during this campaign goes only to the community programs. It is used to pay for the costs directly attributable to serving children and seniors. It does not pay general branch overhead or support other departments.

1980 Community Program Income

$ 43,000	San Francisco Commission on Aging
$ 45,000	United Way
$ 37,000	Grants
$ [illegible]	Fees
$126,000	**Sustaining Campaign**
$257,000	

Our home for heroes.
YMCA
BE A HERO.

CENTRAL YMCA
220 GOLDEN GATE AVENUE
SAN FRANCISCO CA 94102
885-0460

Ymca 4

The Tenderloin is a tough place to grow up and grow old. But with your help it can change. The Central YMCA is working with and for people in the Tenderloin to make their corner of the world a little brighter. Please join with these four individuals to help make the world we all live in a better place.

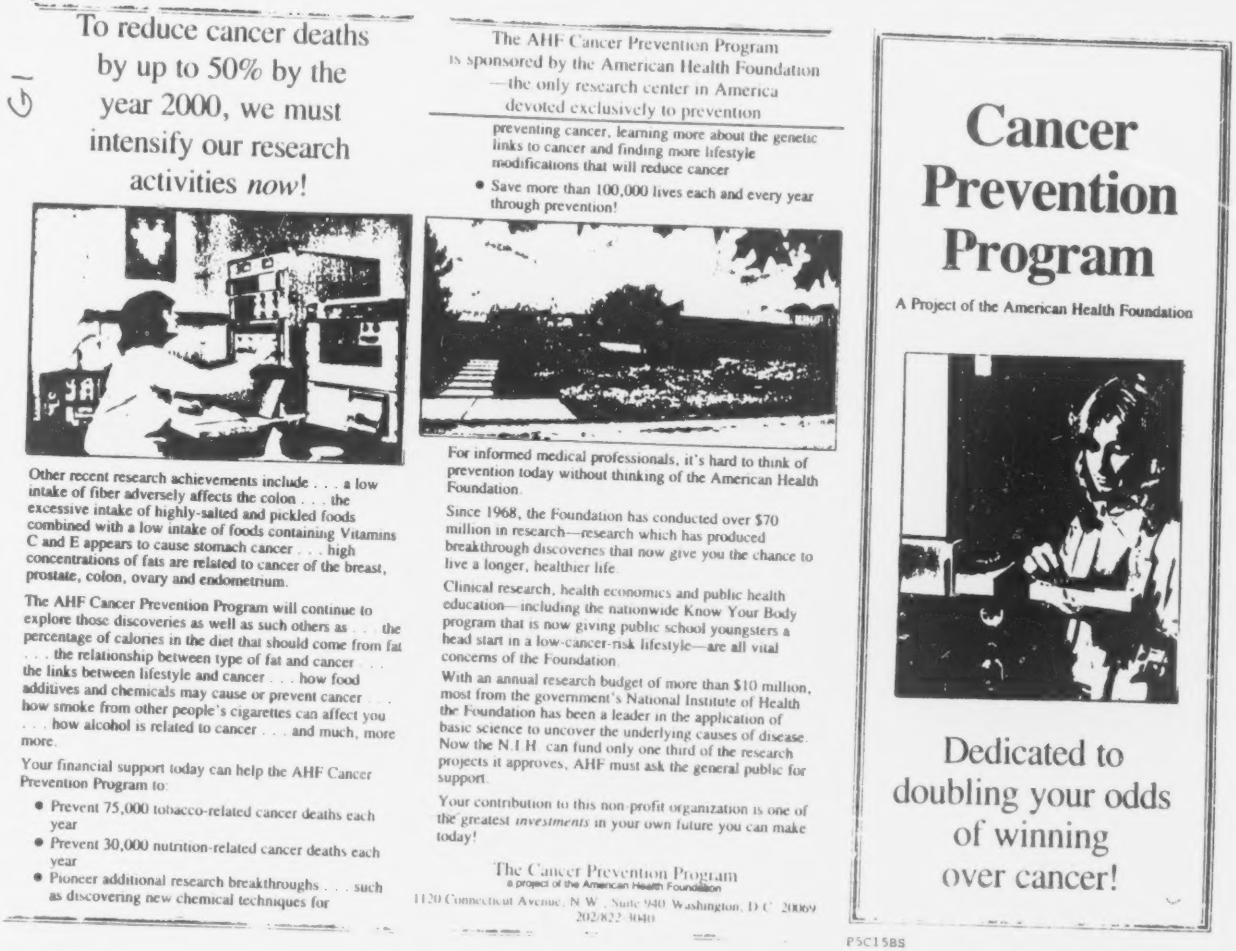
MUEISENG IS A ROLE MODEL TO REFUGEE WOMEN AND MEN ALIKE. She came to this country a Mien woman – a member of a Laotian mountain tribe where no written language exists. Six years ago she found her way to the Central YMCA as a Vista worker in our Youth Services department. Mueiseng, with the help of teachers at the community college, learned to read and write English; no simple task under any circumstances. She went on to serve as a teacher in the YMCA's Refugee Services helping other refugees to speak our language.

"I JUST FIGURED THERE'D BE A Y WHEREVER I WOULD GO," said 8 year old Tiffany who came here from Tampa, Florida. She lives with her mother in the Tenderloin and comes to the Y to swim, rollerskate and play kickball, her favorite sport. Tiffany is also taking a Mandarin Chinese class to enable her to talk to other children in her Tenderloin neighborhood that do not speak English. Before discovering the Central Y, Tiffany used to pretend with her friends in the backyard that they were "at the Y." We don't want children to have to pretend they're at the Y, we want them to actually be able to come and participate.

YEN IS FROM VIETNAM. She's been coming to the Y for several years now and has learned how to rollerskate and swim. "I can swim 30 laps," she says joyfully. Yen put her newly learned skills to good use last summer as a junior counselor, teaching younger children how to swim. But that's not all. She also enjoys volleyball league and karate lessons with the Y. In photo class she has learned how to take photos, develop film and make prints. As for Y campouts, Yen likes meeting and talking to new friends, sleeping in a tent and just looking up at the stars. She says she's very happy the Y is here to enjoy.

POPS IS 87½ YEARS YOUNG. And getting younger every year thanks in part to our Senior Exercise Classes. In the last three years of coming to our Senior Exercise Class 80% of Pop's arthritis has disappeared. He can walk 30 laps around the gym and swim two miles all in the same day. A far cry from the less than four laps around the gym when he first came to us. When Pops was 6 years old he asked God to let his life be a long one and to make his later years the best ones. We bet he'll tell you his prayers have been answered. Pops needs the exercise classes to continue, so that his prayer can go on being answered.

BE A HERO.



To reduce cancer deaths by up to 50% by the year 2000, we must intensify our research activities *now*!

Other recent research achievements include . . . a low intake of fiber adversely affects the colon . . . the excessive intake of highly-salted and pickled foods combined with a low intake of foods containing Vitamins C and E appears to cause stomach cancer . . . high concentrations of fats are related to cancer of the breast, prostate, colon, ovary and endometrium.

The AHF Cancer Prevention Program will continue to explore those discoveries as well as such others as . . . the percentage of calories in the diet that should come from fat . . . the relationship between type of fat and cancer . . . the links between lifestyle and cancer . . . how food additives and chemicals may cause or prevent cancer . . . how smoke from other people's cigarettes can affect you . . . how alcohol is related to cancer . . . and much, more more.

Your financial support today can help the AHF Cancer Prevention Program to:

- Prevent 75,000 tobacco-related cancer deaths each year
- Prevent 30,000 nutrition-related cancer deaths each year
- Pioneer additional research breakthroughs . . . such as discovering new chemical techniques for preventing cancer, learning more about the genetic links to cancer and finding more lifestyle modifications that will reduce cancer
- Save more than 100,000 lives each and every year through prevention!

The AHF Cancer Prevention Program is sponsored by the American Health Foundation —the only research center in America devoted exclusively to prevention

For informed medical professionals, it's hard to think of prevention today without thinking of the American Health Foundation.

Since 1968, the Foundation has conducted over $70 million in research—research which has produced breakthrough discoveries that now give you the chance to live a longer, healthier life.

Clinical research, health economics and public health education—including the nationwide Know Your Body program that is now giving public school youngsters a head start in a low-cancer-risk lifestyle—are all vital concerns of the Foundation.

With an annual research budget of more than $10 million, most from the government's National Institute of Health the Foundation has been a leader in the application of basic science to uncover the underlying causes of disease. Now the N.I.H. can fund only one third of the research projects it approves, AHF must ask the general public for support.

Your contribution to this non-profit organization is one of the greatest *investments* in your own future you can make today!

The Cancer Prevention Program
a project of the American Health Foundation
1120 Connecticut Avenue, N.W., Suite 940 Washington, D.C. 20069
202/822-3040

Cancer Prevention Program

A Project of the American Health Foundation

Dedicated to doubling your odds of winning over cancer!

P5C15BS

G2

Combining the world's most sophisticated technology with the work of over 150 highly-skilled specialists to find the key to preventing avoidable cancer

Today we are pouring more than $200 billion a year into health care in this country. And nine out of every 10 of those dollars goes to cover the cost of what can only be described as sickness care.

And yet with *preventive* health care, good health can last a lifetime.

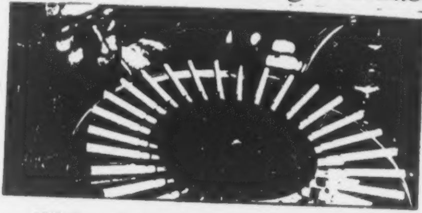
Nature intends for us to live long and live well. And it places many of the factors that lead to long, healthy lives firmly within our control—the lifestyle we lead, the food we eat, the nature of our environment.

But it is up to *us* to understand how to balance these factors into a lifestyle that prevents disease.

Medical science already conquered many of the major health scourges of the past—diptheria, tuberculosis, typhoid, cholera, smallpox and others—through discoveries in preventive medicine.

And now the time has come to do the same with the most dreaded disease of our time—Cancer.

The AHF Cancer Prevention Program is dedicated to finding the keys to preventing 100,000 cancer deaths a year by the end of this century. We are doing this by identifying cancer risks and discovering practical preventive techniques for avoiding them.



And although preventive medicine may eventually gain a much larger share of our country's health care dollars, the AHF Cancer Prevention Program cannot wait. The time has come to cut cancer deaths in half.

The laboratory work of the AHF Cancer Prevention Program is being conducted at the Naylor Dana Institute for Disease Prevention in Valhalla, New York, which houses over 30 of the most modern laboratories for experimentation and analysis available anywhere. The AHF CPP's clinical studies and educational activities are based in its Manhattan offices and are carried out in collaboration with hospitals and schools all over the world.

The AHF Cancer Prevention Program cigarette smoking machines have helped us to break cigarette smoke down into as many as 2,500 compounds—and identify those that pose the greatest risks of cancer. This painstaking research helped lead to today's less-harmful low-tar and low-nicotine cigarettes and may someday provide the key to a "less-harmful" cigarette for the millions of Americans who continue to smoke.

The AHF Cancer Prevention Program's specially-designed Research Animal Facility features housing for germ-free animals and has enabled researchers to again demonstrate that animal experiments are reliable scientific tools that can be utilized to predict the possible effect of cancer-causing agents on human beings.

A sensitive monitoring screen connected to a powerful microscope enables researchers of the AHF Cancer Prevention Program to conduct the "Williams Test" (developed by the chief of the Program's Pathology & Toxicology Division) to detect the damage to genetic material by chemicals and identify mutagens. The staff also maintains cultures of liver, breast, esophagus, urinary bladder and colon cells for controlled study of cancer causation. These approaches reduce the need for animal experimentation.

Recent bombardments of claims about dietary links to cancer have left the public understandably confused. But the AHF Cancer Prevention Program has been working round-the-clock to continue its pioneering role by conducting major studies on the diet-cancer link. For example, Program scientists have recently confirmed suspicions that women who consume high-fat diets secrete large amounts of a hormone related to breast cancer. One of the major goals of the AHF Cancer Prevention Program is to discover new dietary recommendations for the one out of every 11 American women who now can expect to contract this insidious form of cancer.

AHF Cancer Prevention Program

Dedicated to making good health last a lifetime

H1

PACIFIC LEGAL
FOUNDATION

OFFICERS

Chairman of the Board
BROOKS WALKER, JR

Vice Chairmen of the Board
WILLARD Z. CARR, JR
EUGENE von WENING, JR

President and CEO
RONALD A. ZUMBRUN

Executive Vice President
LOIS K. OLSON

Secretary-Treasurer
JOHN F. OTTO

TRUSTEES

JOHN P. ADAMS
Associate
Adams/Jones
Investment Group

JOHN B. BATES
Pillsbury, Madison & Sutro

WENDY H. BORCHERDT
Executive Vice-Chairman
Citizens for the Republic

WARREN H. BROCK
Chairman
Brock Plant Genetics

ROBERT B. CARLESON
Director of Government Relations
KMG Main Hurdman

WILLARD Z. CARR, JR
Gibson, Dunn & Crutcher

ALAN C. FURTH
Vice Chairman
Santa Fe Southern
Pacific Corporation

BEN J. GANTT, JR
Graham & Dunn

ROBERT F. KANE
Former U.S. Ambassador to Ireland
Ropers, Majeski, Kohn
Bentley, Wagner & Kane

J. CLAYBURN LA FORCE, Dean
Graduate School of Management
UCLA

PETER A. McCUEN
McCuen & Steele, Inc

LYN NOFZIGER
Nofziger & Bragg

JOHN F. OTTO
President
Freeport Company

JOHN P. POLLOCK
Rodi, Pollock, Pettker
Galbraith & Phillips

MARC SANDSTROM
Senior Executive Vice President
General Counsel
Great American First Savings Bank

MICHAEL T. THOMAS
Robertson, Monagle & Eastaugh

EUGENE von WENING, JR
Executive Vice President
Turner Construction Company
Chairman, Turner International Industries

BROOKS WALKER, JR
Chairman
United States Leasing
International, Inc

ROBERT W. WALKER, Chairman
Blue Shield of California (Retired)

RONALD A. ZUMBRUN
President and CEO
Pacific Legal Foundation

January, 1987

Dear Friend:

This Ventura County family's struggle to keep their property is one of the most significant land use cases to reach the U.S. Supreme Court in fifty years.

Patrick (shown here with his son Tim) and Marilyn Nollan own a modest beachfront home in Ventura County. For years they had dreamed of replacing an old ramshackle cabin with a larger, three-bedroom home for their growing family. And that's how their troubles started.

> When the Nollans sought a permit authorizing the new construction, the California Coastal Commission demanded in exchange that they dedicate the entire beach portion of their property for public access.
>
> The Commission offered no monetary compensation whatsoever for the loss of property--fully one-third of the Nollan's small 38 x 116' lot.

The results mean the Nollans would no longer be allowed to beach a boat in front of their home. They could no longer set up a volleyball net or even have a cookout on the beach--activities construed as blocking access to the general public.

555 Capitol Mall, Suite 350 • Sacramento, CA 95814 • (916) 444-0154
Seattle Liaison Office: 1200 One Market Union Square • Seattle, WA 98101 • (206) 447-7264
Alaska Office: 807 G Street • Anchorage, AK 99501 • (907) 278-1731

H2

However, the Ventura County couple would still be expected to pay taxes on the beach property.

They also would need to carry property owner's insurance. In the event that a member of the public is injured, the Nollans are likely to be named as defendants in a personal injury action.

In addition, with public access is bound to come public littering of the property. However, it will not be the state that has to clean up the mess--that task will fall to the Nollans.

In effect, this family loses all the benefits of private ownership while being burdened with all its responsibilities.

Pat and Marilyn Nollan decided to protect their property. That's when they came to us here at Pacific Legal Foundation. They prevailed against the Coastal Commission at trial but were reversed by the appellate courts.

> We believe that the Nollans, like so many coastal property owners, are being denied their constitutional right to compensation for the taking of their property.
>
> We believe that the Coastal Commission's actions severely jeopardize our rights as citizens against land seizures by the state.

Apparently the U.S. Supreme Court also regards this issue as one of great importance. On October 20, the Court granted a request for hearing to PLF's clients, Patrick and Marilyn Nollan. Their case will be heard early this spring.

The Supreme Court's positive response points up the broader issues at stake:

> 1) Can government legitimately withhold approval of building and similar permits in an effort to compel property owners to abandon part of their ownership rights-- **without just compensation?**

H3

2) Does the Coastal Commission's action constitute a violation of the Fifth Amendment to the U.S. Constitution? PLF believes it does.

This case has the potential for making a major mid-course correction in the often misguided land use and regulatory law currently on the books throughout the entire nation.

PLF--and the Nollan family--need your help to meet the challenge and opportunity presented by the Supreme Court.

PLF needs to commit its best legal talent to this case.

At the same time PLF is committed to handling its existing 125 cases and legal proceedings across the nation.

This effort on behalf of the Nollans as well as property owners throughout the nation requires additional financial and human resources.

Unfortunately, this opportunity has come at a time when we at PLF face our toughest year financially.

Your special financial support for the Nollans will make the difference in whether we are able to marshall the necessary resources to take full advantage of this opportunity.

For 14 years we have been preparing for just such a challenge as this--it is vital that we do everything within our power to maximize our efforts.

We need your support now.

You can help us achieve these goals and overcome the financial hurdles by making your maximum contribution possible and by letting your friends, neighbors and colleagues know about this case and what is at stake.

Let's get behind the Nollans. Their freedom issue is really all of ours.

H<1

January, 1987
Page 4

When the Nollans prevail, we all will have taken a major step toward restoring individual and economic freedom in our country.

I know we can count on you at this time when your support is more important than ever. Please send your maximum possible contribution in the enclosed envelope as soon as possible.

Thank you for your continued support.

Sincerely,

Ronald A. Zumbrun
RONALD A. ZUMBRUN
President

Enclosure

P.S. The Nollan case is just one of many important issues our dedicated legal staff is currently addressing in defense of our nation's constitutional freedoms.

We can do much more if you help us. Remember: your gift is tax-deductible--and very much appreciated.

H5

San Francisco Chronicle

October 27, 1986

EDITORIALS

The State's Grab

MR. AND MRS. James Nollan own some beach front property north of Ventura. They wanted to replace a small cottage on their land with a larger home and garage. In exchange for a permit authorizing the new construction, the California Coastal Commission demanded that the Nollans agree to grant public access to the beach in front of their home.

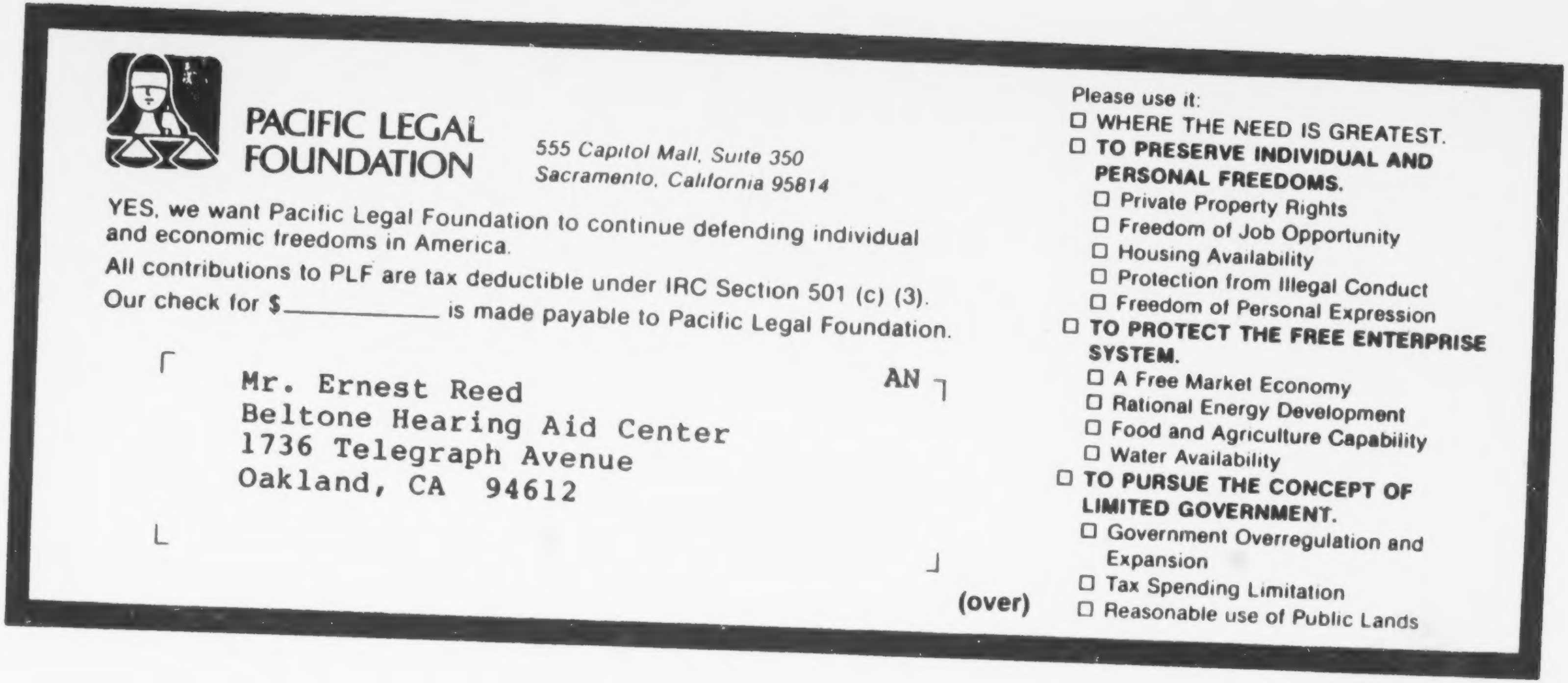
It is important to note that there would be no significant change in the use of the Nollan's land, but merely the replacement of an old and small structure with one which would be newer and larger. And no compensation was offered for the taking of the Nollan's property for public use.

This demand that the Nollans provide the public access across their property in return for a building permit seems to be governmental blackmail. The Nollans have resisted the concept and have gone to court. Although they won their case in Superior Court, they lost in the state Court of Appeal and were refused a hearing by the California Supreme Court.

THE ATTORNEY for the Nollans poses a compelling question: How can the government argue that the Nollan's application for a building permit created a public need for beach access? No such need existed before the application and none would have existed had they not wanted to replace their small cottage.

The Nollan case is now before the U.S. Supreme Court. We trust the court will vigorously reject the idea that governmental blackmail is correct and legal.

© San Francisco Chronicle, 1986.
Reprinted by permission.



PACIFIC LEGAL FOUNDATION

555 Capitol Mall, Suite 350
Sacramento, California 95814

YES, we want Pacific Legal Foundation to continue defending individual and economic freedoms in America.

All contributions to PLF are tax deductible under IRC Section 501 (c) (3).

Our check for $__________ is made payable to Pacific Legal Foundation.

AN

Mr. Ernest Reed
Beltone Hearing Aid Center
1736 Telegraph Avenue
Oakland, CA 94612

(over)

Please use it:

- ☐ WHERE THE NEED IS GREATEST.
- ☐ **TO PRESERVE INDIVIDUAL AND PERSONAL FREEDOMS.**
  - ☐ Private Property Rights
  - ☐ Freedom of Job Opportunity
  - ☐ Housing Availability
  - ☐ Protection from Illegal Conduct
  - ☐ Freedom of Personal Expression
- ☐ **TO PROTECT THE FREE ENTERPRISE SYSTEM.**
  - ☐ A Free Market Economy
  - ☐ Rational Energy Development
  - ☐ Food and Agriculture Capability
  - ☐ Water Availability
- ☐ **TO PURSUE THE CONCEPT OF LIMITED GOVERNMENT.**
  - ☐ Government Overregulation and Expansion
  - ☐ Tax Spending Limitation
  - ☐ Reasonable use of Public Lands

I 1

We rely on the generosity of individual donors as well as grants from foundations. A tax-deductible donation can be made directly or in the form of a memorial gift, tribute, or a bequest in your will.

Please accept my gift of $ ________

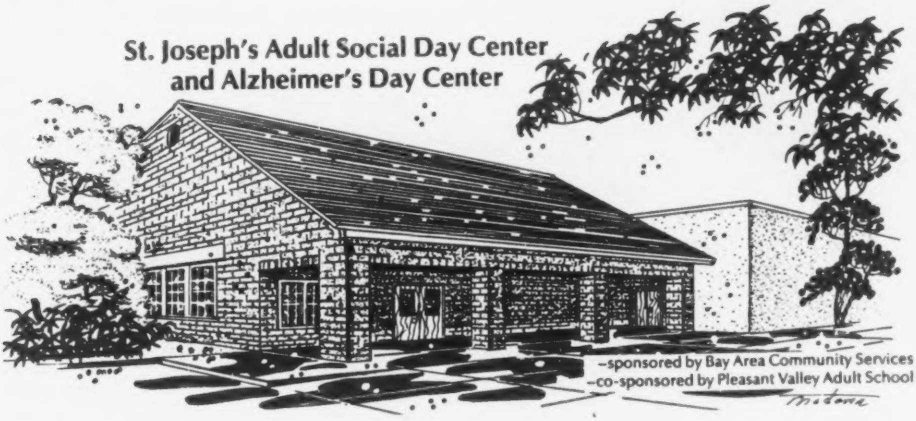
NAME ________________________________
ADDRESS ________________________________
____
PHONE ________________________________

Past donors include:	American Savings and Loan Foundation
Levi Strauss Foundation	Alameda County Department on Aging
East Bay Community Foundation	Soroptimist International of Oakland, Inc.
United Way	Rotary Club

BACS
Bay Area Community Services Inc
2647 E. 14th STREET, OAKLAND, CA 94601
P.O. BOX 12838, OAKLAND, CA 94604

Nonprofit Org
U.S. Postage
PAID
Oakland, CA
Permit No. 3357

St. Joseph's Adult Social Day Center and Alzheimer's Day Center



–sponsored by Bay Area Community Services
–co-sponsored by Pleasant Valley Adult School

I2

CENTER FOR SENIORS WITH SPECIAL NEEDS

Bay Area Community Services now offers two distinct programs serving older adults with special needs.

The Adult Social Day Center is designed for frail seniors, and the Alzheimer's Day Center is especially geared to the needs of memory loss victims and their families.

SERVICES

For both the Alzheimer's Day Center and the Adult Social Day Center, we provide the following:

- ★ Transportation
- ★ Nutritious hot lunch
- ★ Movement to music
- ★ Singing
- ★ Mild exercise
- ★ Arts and crafts
- ★ Memory exercises
- ★ One-to-one interaction
- ★ Reminiscing
- ★ Educational games
- ★ Walks
- ★ Reality Orientation
- ★ Field Trips
- ★ Caregiver support group
- ★ Health education and screening
- ★ Guest speakers

ALZHEIMER'S DAY CENTER

For older adults with Alzheimer's or related memory disorders. We also provide respite and support for caregivers.

Mondays from 9 a.m. to 2:00 p.m.

ADULT SOCIAL DAY CENTER

For frail older adults with special needs.

Meets Tuesdays and Thursdays
9 a.m. to 2:00 p.m.

WHO'S ELIGIBLE?

Older adults with special needs are welcome regardless of national origin, race, religion or sex. Cost is based on a sliding scale; no one will be denied services because of inability to pay.

For information about the Center's programs, call Bay Area Community Services at:

Steve Share

436-0141

Funded in part by a grant from the Levi Strauss Foundation.
Co-sponsored by Pleasant Valley Adult School, Oakland Unified School District.

HILLSDALE COLLEGE

April, 1987

Miss Alice J. Gallagher
Beltone Hearing Aid Center
1736 Telegraph Avenue
Oakland, CA 94612

I never request anything J1

Dear Miss Gallagher:

I am writing to welcome you as a new subscriber to IMPRIMIS, the monthly journal published by Hillsdale College to encourage clear thinking on the problems of our time. Dr. James Juroe, Director of our Family Business Institute, has arranged for you to receive an IMPRIMIS subscription for the coming year at no charge. You might well ask, why me? The answer is simply that Jim and I thought you would want to know about a little academic institution that reflects those same qualities he saw last summer in the delegates to the White House conference -- courage, resiliency, energy, intelligence and imagination. (You may be interested to learn that Hillsdale College was the only college in the country that thought the proceedings of the White House Conference of sufficient importance to send a registered observer.)

To give you an idea of what is in store, I enclose our latest issue of this unusual little monthly. We hope you will enjoy its timely subjects, outstanding authors, and concise format. Over the years thousands of readers have told us how useful IMPRIMIS is for them in evaluating the news, making business decisions, carrying on educational work, pursuing their political concerns, providing background for the writing and speaking they do. We hope your experience as a new reader matches theirs.

We started IMPRIMIS in 1972 as an experimental forum through which to share fresh ideas with about a thousand friends each month. Today, monthly circulation is nearly 125,000. Along the way, many major national figures have been featured in our pages. Because of our commitment to independence, Hillsdale has had to fight a long court battle. We take no government money and refuse to succumb to government control.

Reading IMPRIMIS will give you a personal window on Hillsdale College at work. That's because it publishes some of the best papers written for our own programs -- public policy seminars in the Center for Constructive Alternatives, leadership seminars in our Shavano Institute, economics lectures in our Ludwig von Mises Series, convocations of the Christian Studies Program at Hillsdale, and others.

We want to make IMPRIMIS as useful as we can to friends like you. When you have read the first several issues, please write me a note with your impressions. And remember, it comes at no obligation to you whatsoever. Though it costs Hillsdale $15 or more per year to provide each subscription, gifts from donors fully cover these costs. Later, if you feel we've earned it, your donation can make possible similar free subscriptions for others. So welcome aboard, and good reading.

Sincerely,

J. A. McNamara

Joe McNamara
Vice President for External Affairs

HILLSDALE, MICHIGAN 49242 (517) 437-7341 • (517) 439-1524

J2

The Center for Constructive Alternatives
Hillsdale College
Hillsdale, Michigan 49242

Non-Profit Org.
U.S. Postage
PAID
Permit No. 100
Detroit, MI

THIS IS YOUR REMOVABLE MAILING LABEL.

PLEASE ATTACH TO YOUR RETURN ENVELOPE.

294028 687
MISS ALICE J GALLAGHER
BELTONE HEARING AID CENTER
1736 TELEGRAPH AVENUE
OAKLAND, CA 94612

Do Not Forward
Address Correction Requested
Return Postage Guaranteed

HILLSDALE COLLEGE

☐ Enclosed is my tax-deductible contribution to help Hillsdale College continue to provide seminars, **IMPRIMIS,** and other publications to an international audience and to help Hillsdale maintain its independent stand in the field of liberal arts education, free of government funds.

☐ Please begin a free subscription to **IMPRIMIS** for the name(s) enclosed

☐ Please send me information about the College's
  - ☐ Center for Constructive Alternative seminars
  - ☐ Shavano Institute for National Leadership seminars
  - ☐ Alternatives (illustrated economics essays and posters)
  - ☐ Family Business Institute
  - ☐ Hillsdale College Press (catalog and price list)
  - ☐ Admissions

Please attach removable mailing label to this envelope

☐ Enclosed is my check (payable to Hillsdale College) for:

IMPRIMIS reprints Vol.____ No.____ Author ____________
Essential Imprimis ($5.00 each) Vol.____ Title ____________
Alternatives (30 essays, a complete set, $10.00)____________
Posters (1 set of 15, $10.00) ____________
Book(s) by George Roche____________
Champions of Freedom series ($5.00 each) Vol. ____________
The Christian Vision series ($5.00 each) Vol.____________
Other Books from the Hillsdale College Press ____________

IMPRIMIS REPRINT PRICES
(postpaid)
____1-10 copies $ .75 each
____25 copies $10.00
____50 copies $15.00
____100 copies $30.00

Please attach removable mailing label to this envelope

J3

NEW READERS SAMPLER

IMPRIMIS

Imprimis, the Hillsdale College publication presenting thought-provoking papers from seminars of the Center for Constructive Alternatives and the Shavano Institute for National Leadership, remains timely through the years. For your reading enjoyment as a new subscriber, we invite you to select any three *Imprimis* issues from the recent past. Please check the three you wish to receive.

[ ] "The Only Way to Peace" Winston Churchill II, British defense expert and Member of Parliament, debunks the nuclear freeze movement.

[ ] "Rebuilding the Private Sector" *Reason* editor Robert Poole outlines the alternative to ever-bigger government.

[ ] "The Crisis of Modern Learning" Carl F. H. Henry, theologian and author, explores the crisis confronting higher education.

[ ] "Responsibility and Race" Glen Loury, black studies professor at Harvard, asks whether the melting pot still works in America.

[ ] "How Conservatism Guided America's Founding" Historian Forrest McDonald says the radicals lost at Philadelphia.

[ ] "Totalitarianism in Nicaragua" Humberto Belli, survivor of the Sandinista revolution, warns the U.S. about Marxist influence.

[ ] "Who Killed Excellence?" Samuel Blumenfeld, a well known educator, goes beyond trendy analysis to describe what's really wrong with our educational system.

[ ] "Free Trade Under Attack: What America Can Do" Murray Weidenbaum, leading economist, examines the case for a free trade policy in our economy.

[ ] "Dare We Separate Christian Morals and the Rule of Law?" Russell Kirk, dean of modern conservatives, tells why not.

[ ] "Idea Fashions of the Eighties: After Marx, What?" Tom Wolfe, author and irrepressible social critic, wills Americans to formulate a coherent philosophy of freedom.

[ ] "The Myth of Moral Equivalence" Former U.S. Ambassador Jeane J. Kirkpatrick challenges the doctrine which equates the behavior of the two "superpowers," the United States and the Soviet Union. The feature essay in *Scorpions in a Bottle: Dangerous Ideas About the United States and the Soviet Union* by the Hillsdale College Press.

[ ] "A World Without Heroes" George Roche, President of Hillsdale College, traces the abandonment of values and beliefs which has characterized the development of the modern social order. He suggests that in recovering our true heroes, we may find our salvation as individuals and as a society.

OPTIONAL: My tax-deductible contribution of $_____, $100, $50, $25 is enclosed to help Hillsdale reach other concerned Americans with free *Imprimis* subscriptions.

NAME____

ADDRESS______________________________________

CITY, STATE, ZIP_________________________________

Because Ideas Have Consequences
Hillsdale College Hillsdale, Michigan 49242
517-437-7341

K1

The TRIUNE

JUNE
SUNDAY SERVICES

10:00AM REV. CAROL NEALE	11:30AM DR. JAY SCOTT NEALE
7 - "KARMIC CONSEQUENCES"	7 - "YOU CAN HAVE THE BEST!"
14 - "ERNEST HOLMES- MY TEACHER, MY FRIEND" Dr. Craig Carter, 10:00 & 11:30AM	
21 - "CONFIDENCE IN GOD"	21 - "A RECIPE FOR MIRACLES"
28 - "THINGS INTO THOUGHTS"	28 - "SOURCE OF ALL HEALING"

WEDNESDAY EVENINGS

MINISTRY of HEALING - 7:00 p.m.

LECTURE - 8:00 p.m. DR. JAY SCOTT NEALE

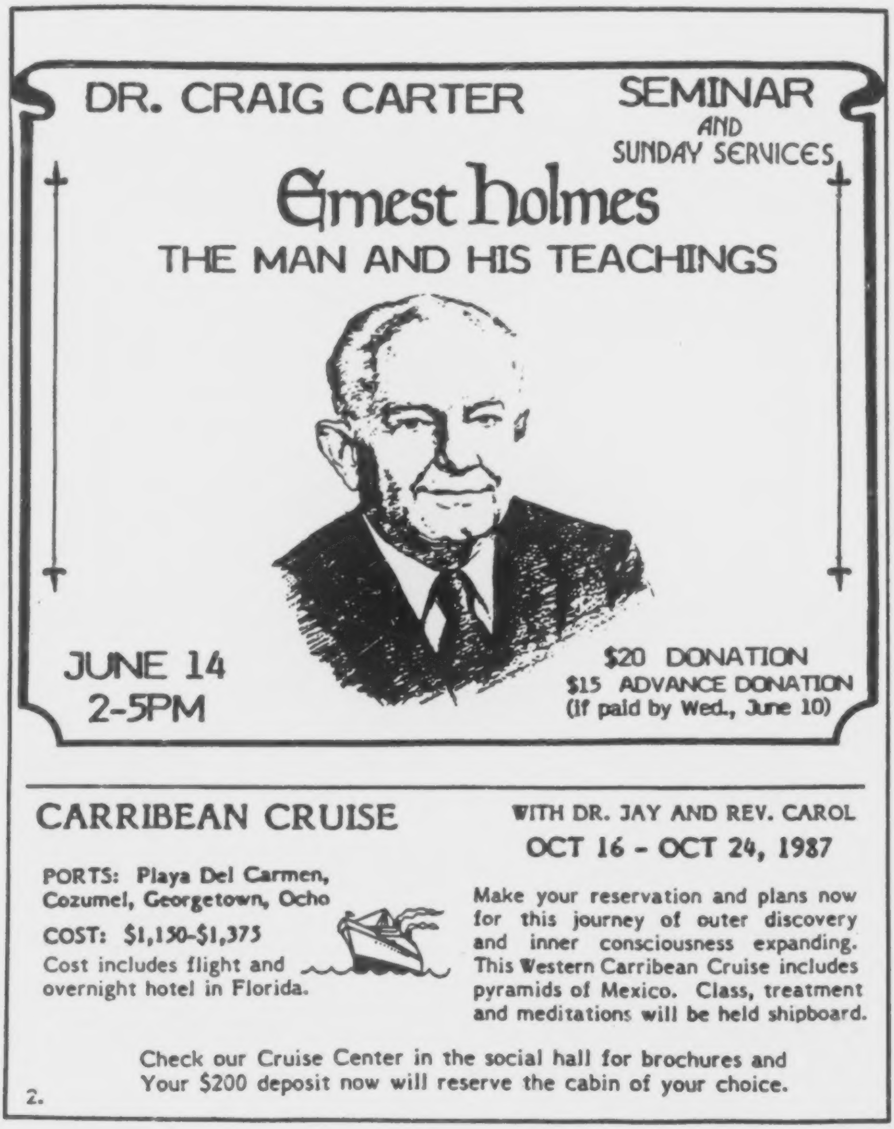
Focus: "TAKING CHARGE"

3 - "TAKE CHARGE OF YOUR LIFE"
10 - "TAKE CHARGE OF YOUR LOVE"
17 - "TAKE CHARGE OF YOUR TALENT"
24 - "TAKE CHARGE OF YOUR SUCCESS"

Tri-City Church of Religious Science

MEMBER OF RELIGIOUS SCIENCE INTERNATIONAL AND INTA

K2



DR. CRAIG CARTER

SEMINAR
AND
SUNDAY SERVICES

Ernest Holmes
THE MAN AND HIS TEACHINGS

JUNE 14
2-5PM

$20 DONATION
$15 ADVANCE DONATION
(If paid by Wed., June 10)

CARRIBEAN CRUISE

WITH DR. JAY AND REV. CAROL
OCT 16 - OCT 24, 1987

PORTS: Playa Del Carmen, Cozumel, Georgetown, Ocho

COST: $1,150-$1,375

Cost includes flight and overnight hotel in Florida.

Make your reservation and plans now for this journey of outer discovery and inner consciousness expanding. This Western Carribean Cruise includes pyramids of Mexico. Class, treatment and meditations will be held shipboard.

Check our Cruise Center in the social hall for brochures and Your $200 deposit now will reserve the cabin of your choice.

2.

K3

DR. JAY SCOTT NEALE

REV. CAROL NEALE

Dear Friends,

This month it is our pleasure again to welcome my teacher and my friend, **DR. CRAIG CARTER**. June 14 will be a very special Sunday. Invite your friends and come experience Dr. Carter's wonderful tribute to Dr. Ernest Holmes Sunday morning - and a great seminar sunday afternoon.

Let us join in the understanding of Romans 8:16, "...we are children of God, and if children, then heirs; heirs of God, and joint-heirs with Christ ..."

We are each a channel of Divine Expression on the physical plane. Know this is true and affirm:
I AM THE FULFILLMENT OF POSITIVE GROWTH IN ACTION.

Love is blessing us

Dr. Jay

P.S. I've got a super class planned this summer that will be "GOOD FOR YOU". DON'T MISS IT!

Dear Friends,

I find a source of inspiration in reading Emerson's essays. I like to take a single sentence and open it out, personalizing it by questioning myself. One such gem of wisdom I contemplated was, "SOME THOUGHTS ALWAYS FIND US YOUNG AND KEEP US YOUNG."

As I paused to discover what thoughts find me young, I found that certain nature experiences are always accompanied by an attitude of thought that is timeless and restoring. Also, in relating to people I enter a moment always new and expanded.

When I put these ideas together in a life career setting, I get Jesus and his outdoor ministry!

Give yourself an experience with Emerson. He's always available to fit your schedule!

I love you,

Rev. Carol

K4

REV. SHARON

June has been one of my favorite months. It's warmth feels like a picnic, a walk in the woods or a day at the ocean. As I partake of all the joys of summer, it arouses a greater personal awareness of the Spiritual Nature of the universe. The more in oneness I become, the more I give, knowing my source is infinite - GOD.

If you would like to do some summer giving, consider filling out our Volunteer Form, bringing goodies to a service or sharing flowers from your own garden. HAPPY SUMMER!

Volunteer Of The Month

LICENSED PRACTITIONERS

CHARLENE COURADE
RICK DANIEL
LINDA GRAND
JANE HOLT
DENIS LaROCHE
NORMA LUNZ
SYDNEY MARSH
JAN SMILEY

INTERN PRACTITIONERS

LORETTA HENDERSON
JACK HERRIS
DICK MAR
SALLY RICHARDSON
BARBARA SPANGLER
DON SPANN
JANIS VOGEL
PAT WINEGAR
DOUG VAN WOERKOM
PATRICIA VAN WOERKOM

This beautiful group of people are intimate supporters of the church. They join us in treatment every day on a monthly theme, support every board project with treatment, participate in Ministry of Healing weekly, treat during every service and are available for answering questions after. Their high spiritual consciousness is also available to members and friends who desire a personal consultation.

We appreciate these people more than words can possibly convey.

WELCOME NEW MEMBERS

We lovingly welcome the following new members to our Church family: **Rick Diaz, Grace Manley, Eve and Ross McElhery, Mercy Smith, Kimball Service and Jan Schleinhofer.**

GREAT DEMONSTRATION UPDATE

Let's all participate lovingly in acceptance and donation to pay the 2nd Note due Oct. 1, 1987.

- $81,700 TO GO -

PRACTITIONER FOCUS

The practitioners invite you to join them in treatment this month expressing the consciousness of -

"I REJOICE IN MY DIVINITY."

You Are All Invited
to the

FOURTH YEAR GRADUATION
SUNDAY - JUNE 28
5:00PM

Share in this celebration
of completion of 5 years
of study - For:

RICK DANIEL
JACK HERRIS
TOM ROGELLS
JANE HOLT
JANIS VOGEL
NORMA LUNZ
RENE' DROLET
LORETTA HENDERSON
PAT WINEGAR
CHARAN WOLLARD
MARGARET WESTERFIELD

We congratulate them.

Talks will be on the qualities of God.

K5

1987
SUMMER CLASSES

**THE TRI-CITY CHURCH OF
RELIGIOUS SCIENCE**

40155 Blacow Road
Fremont, CA 94538
415-656-9955

K6

START YOUR SUMMER IN A POSITIVE WAY.

YOU ARE INVITED TO EXPERIENCE
DR. JAY'S SUPER SUMMER CLASS -

good
for you

The Science of Mind Approach
to Successful Living

Selected writings of
Ernest Holmes

JUNE 8,15,22 & 29

7:30 - 9:30PM MONDAYS	$30 CLASS DONATION + Book $13.86 (Incl. tax) "Good For You" by Ernest Holmes

---

JOIN IN EXPLORING -

- THE GREATEST DISCOVERY EVER MADE
- THE GIFT OF CREATIVITY
- THE DYNAMICS OF SPIRITUAL MIND TREATMENT
- PHYSICAL HEALTH, PROSPERITY, SELF-CONFIDENCE BUSINESS, LOVE AND FRIENDSHIP
- "GOOD FOR ME" EXERCISES FOR PERSONAL APPLICATION

THIS CLASS IS GUARANTEED TO BE "GOOD FOR YOU!"

BE THERE !

TAKE A "MEDITATION JOURNEY" with REV. CAROL

JOURNEY INTO INNER SPACE
with the lift-off power of group consciousness,
then soar on your own !

Meditation will open you to greater recognition of your inner light. It is also the royal road to developing your use of intuition.

JUNE 3,10,17 & 24

$20 DONATION

8:00-9:15PM
WEDNESDAYS

The Manifestation Process

JULY 6,13,20 & 27

by REV. CAROL NEALE

ARE YOU DEMONSTRATING WHAT YOU WANT IN LIFE?

WOULD YOU LIKE TO UNDERSTAND YOUR LIFE EXPERIENCES MORE CLEARLY?

DO YOU HAVE A VISION TO FULFILL?

Join in this mind and consciousness expanding class experience.
It all begins and ends in YOU!

$30 DONATION
+ Book $4.23 (Incl. tax)
"The Manifestation Process"
by John Randolph Price

7:30-9:30PM
MONDAYS

K8

S.O.M. I - Creative Mind & Law

by REV. SHARON DANIEL
&
4th Year Students

JUNE 9, 16, 23, 30
JULY 7, 14, 21, 28

This is a great class to consider basic principles of the Law of Mind. Either as a new student or as a review student - FIRST YEAR is always new as you deepen your understanding.

This is an interactive class with discussion and workshops to meet your specific needs.

Book: "SCIENCE OF MIND" by Ernest Holmes, $19.65 tax incl.

TUESDAYS - 7:00PM **$60 DONATION - $45 REVIEW (with certificate)**

REGISTRATION FORM

Please register me for class.

Name________________________

Address________________________

____

Phone: Home______________ Work____________

Enclosed is $______ for Class $______
Books $______

I plan to attend these classes:

Please mail form or turn in at Center.

THE TRI-CITY CHURCH OF RELIGIOUS SCIENCE
40155 Blacow Road
Fremont, CA 94538
415-656-9955

ADVANCE REGISTRATION ALLOWS US TO PREPARE MATERIALS.

Please order books in advance.

- ____ **"GOOD FOR YOU" by DR. JAY**
  MON. - JUNE 8, 15, 22, 29 - 7:30-9:30PM
  $30 + book.
- ____ **"MEDITATION JOURNEY" by REV. CAROL**
  WED.- JUNE 3, 10, 17, 24 - 8-9:15PM - $20
- ____ **THE MANIFESTATION PROCESS by REV. CAROL**
  MONDAYS-JULY 6, 13, 20, 27 - $30 + book.
- ____ **S.O.M. I - Creative Mind & Law by REV. SHARON**
  TUES.- JUNE 9, 16, 23, 30 JULY 7, 14, 21, 28 - $60 + book

Check in early at the Bookstore 1st class to register & buy books.

K9

Communication Dynamics

. . . An Exciting New Concept In Communication Training ! !

FRIDAY - JUNE 5 & SATURDAY - JUNE 6
7:30-10:00PM & 9:00AM-4:00PM

In this 12 hour participatory session you will learn to:

- Say What You Really Want to Say.
- Develop Poise & Self-Confidence.
- How to Listen & Appraise Performance in a Supportive Environment.
- Extemporaneous & Impromptu Speaking Skills.
- To Effectively Use Microphones.
- Video Camera Will Be Used.

Instructed by:
RUBY WATSON & MARIE EASTMAN

$90 Seminar Donation
$75 Advance Donation
(If paid by June 3)

* Cost of seminar includes $35 book.

THE BOOK STORE

This month, we are featuring Dr. Jay's newest tape album - "THE MILLIONAIRE SERIES"

This fabulous new 5 tape album contains the following $ $ $ ideas:

- THINK LIKE A MILLION
- LOOK LIKE MILLION
- ACT LIKE A MILLION
- FEEL LIKE A MILLION
- PLAY LIKE A MILLION

REMEMBER- ORDER ANY SERVICE TAPE BY MAIL FOR $4.50 + $1.00 FOR MAILING.

Be sure to include: Date, Title and Speaker, along with your name, address and phone number.

NON-MEMBER REQUEST -

We love sending you our monthly TRIUNE so that we may keep you informed of the Church News and our many varied activities. However, we would welcome your support. A contribution of $10 or more from our NON-CHURCH MEMBERS would greatly help to defray the costs of printing and mailing. We thank you.

PVC -

The Tri-City Church will host a regional meeting of Jr.Church teachers and ministers on Saturday, June 27.

JUNE 13 - JOIN A SATURDAY WORK PARTY
10AM-4PM

GARDENING - PAINTING
MAINTENANCE - CLEAN-UP
Lunch Provided

K10

JUNE 1987

SUN	*MON*	*TUE*	*WED*	*THU*	*FRI*	*SAT*
Sunday Services 10 & 11:30	1/	2/	3/ Tai Chi 6PM Ministry Of Healing-7PM SERVICE-8PM MEDITATION CLASS -8PM	4/ Practitioner Mtg. 7:30PM	5/ COMMUNICATION DYNAMICS 7:30-10PM	6/ TAI CHI 10AM 9AM-4PM
7/	8/ GOOD FOR YOU - 7:30PM	9/ SM I - 7PM	10/ Tai Chi 6PM Ministry Of Healing-7PM SERVICE-8PM MEDITATION CLASS-8PM	11/	12/	13/ WORK PARTY 10AM-4PM TAI CHI 10AM
14/ Craig Carter Seminar-2-5PM & Both Services	15/ GOOD FOR YOU - 7:30	16/ SM 1 - 7PM	17/ Tai Chi 6PM Ministry Of Healing-7PM SERVICE-8PM MEDITATION CLASS-8PM	18/ SM IV - 7PM	19/	20/ TAI CHI 10AM
21/ HAPPY FATHER'S DAY ! ! !	22/ GOOD FOR YOU - 7:30	23/ SM 1 - 7PM	24/ Mailing-9:30AM Ministry Of Healing-7PM SERVICE-8PM Med.Class-8PM	25/ BOARD MTG. 7:30PM	26/ Relationship 7PM	27/
28/ SM IV Graduation-5PM Ministry Of Healing-11AM YOUTH SUNDAY PROSPERITY 12:45PM	29/ GOOD FOR YOU - 7:30PM	30/ SM 1 - 7PM		*** Beginning In June *** YOUNG ADULT YOUTH GROUP AGES 19 to 30 MEETS - SUNDAYS 7-9PM		

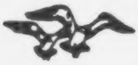
SUMMER CLASSES

"GOOD FOR YOU" by DR. JAY
MON. - JUNE 8, 15, 22, 29 - 7:30-9:30PM
$30 + book, $13.86 incl. tax

"MEDITATION JOURNEY" by REV. CAROL
WED.- JUNE 3, 10, 17, 24 - 8-9:15PM - $20

THE MANIFESTATION PROCESS by REV. CAROL
MONDAYS-JULY 6, 13, 20, 27 - $30

S.O.M. I - Creative Mind & Law by REV. SHARON
TUES.- JUNE 9, 16, 23, 30 JULY 7, 14, 21, 28 - $60



BOARD MEMBERS

Pastor: Dr. Jay Scott Neale
President: Rev. Carol Neale
1st Vice-President: Jack Herris
2nd Vice-President: Barbara Spangler

Members: Jane Holt, Sonya Spencer
Robin MacKenzie, Roberta Noffsinger
Non-voting: Rev. Sharon Forche-Daniel, Secretary - Leila Boots,
Treasurer - Tom Gill

CHURCH ACTIVITIES

Staff: Carol Owen, Nan Carol Self
Volunteer Coordinator; Rev. Sharon Forche-Daniel
Jr. Church: Beth MacKenzie
Teachers: Kathy Hilf, Gail Betty,
Alt.: Beryl Reid, Patti Lopez
Advisor: Lin Grand
Free Flyer Youth Group: Nan Carol Self & Robert Fitzsimmons
Jr. High Youth Group: Cher Wollard
Service Assistants: Rick Daniel, Robin MacKenzie, Bob Fitzsimmons, Jim McGrogan, Tom Boyd
Hospitality: Pat Winegar, Helen Ball
Bldg. & Grounds: Bob Fitzsimmons

PRACTITIONERS

Call for appointments.

Dr. Jay Scott Neale	656-9955
Rev. Carol Neale	656-9955
Rev. Sharon Forche-Daniel	209-836-0458
Linda Grand	490-0610
Charlene Courade	656-9955
Sydney Marsh	471-4467
Jan Smiley	490-7478
Denis LaRoche	408-267-2091
Jane Holt	828-0314
Rick Daniel	209-836-0458
Norma Lunz	790-3509

Recommended fee for 1 hr. personal consultation is $20. However, treatment work is never withheld due to inability to pay.

CREATIVE LIFE SCHOOL

Year round school with extended day options for working parents.

Pre-Kindergarten: Ages 3,4,5
Kindergarten - Sept. 1987

Full Curriculum in a loving atmosphere.

School Year: Sept. 1 - June 30
Summer Program: Jul. 1-Aug. 31

Director/Teacher: Linda Grand

Teachers: Lynn Florreich
Cheryl Fox

Extended Day Care:
Elizabeth MacKenzie

Curriculum and registration materials available in the office.
10 AM TO 6 PM

SPECIAL INTEREST GROUPS

GET INVOLVED . . . JOIN A GROUP
Check calendar for the time & dates.

PROSPERITY GROUP meets the 4th Sunday of the month at 12:45PM.

RELATIONSHIP GROUP led by Betty O'Brien, meets the 4th Friday each month for discussion and social interaction.

HOSPITALITY GROUP led by Helen Ball and Pat Winegar meets one Sunday a month at 12:45PM.

MEMBERSHIP GROUP led by Barbara Spangler. If interested, call 793-4498.

MAILING CREW led by Patti Lopez. We welcome and appreciate anyone wishing to help in our monthly mailing of the TRIUNE and occasional special mailings.

K12

SUNDAY

SUNDAY SERVICES	10:00 AM and 11:30 AM
JUNIOR CHURCH	10:00 AM and 11:30 AM
CHILD CARE	All Services

FREE FLYERS - High School Group
Meets every Sunday 7-9PM

JR. HIGH YOUTH GROUP
1st & 3rd Sundays 7-8PM

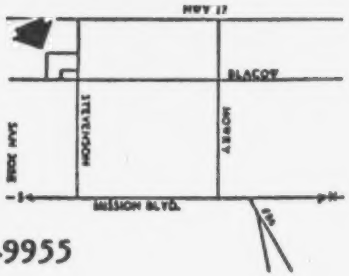
WEDNESDAY

EVENING LECTURES	8:00 PM
MINISTRY OF HEALING	7:00 PM

- All are welcome

Religious Science Center

40155 Blacow Road
Fremont, California



PHONE
415-656-9955

Tri-City Church of Religious Science

POST OFFICE BOX 1751
FREMONT, CA 94538-0175

ADDRESS CORRECTION REQUESTED

Non-Profit Organ.
U.S. POSTAGE
PAID
Fremont, CA
Permit No. 179

↑ Return to sender No such person

This is a Business

Stephen Fried
91 Jackson Street
Hayward, CA 94544

June 1987

RADIO Start your day with Dr. Jay at 6:30 AM, on KEST Radio, 1450 AM.

weekday center hours: 10 AM to 3 PM

treatment line 415-797-LOVE

CIRACS, INC.
5674 Stoneridge Drive, Suite 108
Pleasanton, CA 94566
(415) 463-2182

OFFICERS
PETER SNYDER
President
JOYCE OWEN
Vice-President
CAROL STARR
Secretary
JERRY AJLOUNY
Treasurer

9-2-86

Dear Bill,

Enclosed is the information you requested on CIRACS.

As you can see, we are developing a network of human service providers involved in alcohol and drug programs in both Alameda and Contra Costa counties. By the end of next year, we hope to expand the network to include over 200 programs.

If you would like further information, please give me a call at 463-2182.

Sincerely,
Carol Olmert
Assistant Project Director

L2

C•I•R•A•C•S

A HUMAN SERVICES NETWORK

WHAT IT IS

CIRACS is a network of human service providers linking the public, private, and corporate sectors. A non-profit organization established in 1985, CIRACS began as an outgrowth of the Valleys Corridor Project which pinpointed the need for a computerized network system for collecting, analyzing and disseminating information about human care services in the Valleys Corridor communities.

Funded by United Way and other sources, CIRACS is currently concentrating on programs involved in substance abuse and mental health. Phase I is a complete link-up of all substance abuse service providers in the area. Phase II will establish a network of childcare providers. Based on community needs, other subgroups of human care providers will be added to the CIRACS network.

L3

WHAT IT DOES

CIRACS helps its members in three ways:

Communications and Resource Sharing. Through an electronic mail system, CIRACS allows all its members to instantly share data and resources. For example, members might use the network to determine which of them best meets a client's need; they could share planning data about each other's programs; they could work together on joint funding proposals; they might even recommend books or journal articles they have found useful.

Members are helped to have access to outside resources, such as BAIRS (Bay Area Information and Retrieval System), a coordinated on-line community information system containing up-to-date descriptions of human services or NIDA's (National Institute on Drug Abuse) grant database.

Technical Assistance. CIRACS members receive technical assistance in the use of computers for client services, program management, planning and evaluation. Whether a member agency is just starting or wants to upgrade its computer system, CIRACS provides training and evaluation programs for the in-house use of computers.

Planning and Development. CIRACS continually compiles and analyzes community planning data which helps to identify service gaps or problems. It also assists members in the development of new services.

HOW TO USE IT

- Those members who have a computer with a modem can request and receive information directly from the CIRACS' system.

- A computer terminal with a printer which turns the telephone into a typewritten message system can also be used.
- Members can use CIRACS even if they don't have a computer system. They simply phone in their request to a designated CIRACS affiliate and call back the next day for results.

WHY JOIN?

CIRACS offers members a variety of advantages:

Shared Resources. Service providers - each one being a unique and vital part of an overall picture - are too often isolated. CIRACS enables them to work together as one unit to share their knowledge and referrals.

Easy Access to Information. CIRACS' electronic mail system provides 24-hour access to the resources and expertise of hundreds of other members, enabling them to provide their clients with fast, efficient service.

Streamlines Referral Services. CIRACS helps cut down on shuffling clients from one agency to another. Because CIRACS members have a direct link to a wide range of human services, they can quickly locate the best service for their clients. They will also receive more appropriate referrals from other members.

Ties into Outside Systems. CIRACS will help members to hook up to other on-line data resources, such as BAIRS and NIDA.

Quickly Identifies New Problems. By continually compiling and analyzing community data, CIRACS can help to identify new problems or service gaps within a relatively short time frame.

CIRACS NETWORK PARTICIPANTS

Alameda County Alcohol and Drug Services
Alameda County Health Agency-Valley Mental Health Center
Alcoholism Council of Contra Costa
Amador/Pleasanton School District-Dept. of Special Services
CPC Walnut Creek Hospital
The Center-Counseling, Education and Crisis Services
Center for Human Development
Contra Costa County Health Services Dept. A-DA-MH Division
Family Service Agency of the East Bay
Horizons Youth and Family Services
Lawrence Livermore Labs-Office of Health Services
Pacific Bell-Medical Department, Counseling Services
Phoenix Outpatient Programs
San Ramon Valley Community Center
Tri-Valley Haven for Women

CIRACS BOARD OFFICERS

Peter Snyder, President
Joyce Owen, Vice President
Carol Starr, Secretary
Jerry Aljouny, Treasurer
Bill Foster
Elissa Glickman

CIRACS STAFF

Rosemarie E. Falanga, MLS, Project Director
Carol Olmert, Assistant Project Director

CIRACS, INC.

Comprehensive Information Referral
Assistance Computer System

5674 Stoneridge Drive, Suite 108
Pleasanton, CA 94566
(415) 463-2182

MK

Citizens for Decency through Law, Inc.
11000 North Scottsdale Road, Suite 210 • Scottsdale, Arizona 85254 • 602-483-8787

Dear Friend:

Pre-teen girls molested and raped! (But what can I do about it?)

Little boys and girls forced to make obscene films together! (But what can I do about it?)

Hundreds of thousands of children forced into prostitution! (But what can I do about it?)

Filthy books on every newsstand, filthy movies in every videocassette rental store!

How many times have you said "That's horrible, that's disgusting! BUT WHAT CAN I DO ABOUT IT?"

I have the answer for you. My name is Charlie Keating, and in 1957 I founded Citizens for Decency through Law. CDL for short.

CDL lets decent people, people who are concerned that our beloved nation is going to be submerged in filth, in sexual violence, in sexual assaults upon our children and our grandchildren -- people like you -- do something about it.

CDL is the oldest, the largest, the most effective weapon that the decent people of this nation have to protect themselves and their families against the onslaught of the sex merchants.

CDL is special, because it fights for you in the courts, where this battle is going to be won or lost. It fights for you in the courts of your hometown and in the federal courts -- and most especially in the United States Supreme Court. (CDL has been involved in virtually every important obscenity case in the Supreme Court.)

CDL is special. And it is effective. And without it, this nation of ours would right now be wallowing in filth unimaginably greater than we have today!

Hard to believe? But absolutely true.

In just the past few months, CDL's team of five full-time lawyers -- lawyers who are the most experienced in the country in prosecuting pornographers -- have scored significant victories in courtrooms across America.

In Indianapolis, where CDL attorney Ben Bull was co-prosecutor in the first-ever conviction of a videotape store owner. In Brazos County, Texas where CDL attorneys Bruce Taylor and Paul McCommon helped the county win a conviction on three videotapes and 200 hard-core magazines.

In Washington, D.C. where CDL attorneys have taken on both Penthouse and Playboy magazines to force these merchants of muck to stop their attack on the Attorney General's Commission on Pornography. (Both Playboy and Penthouse want parts of the Commission's report -- a report that absolutely links pornography with sexual violence -- to be suppressed, concealed, hidden from the American public.)

What can YOU do about it?

You can support CDL. Starting now you can lend your moral and your financial and your spiritual support to the people who will save this country, your country, from the absolute degradation which otherwise awaits us.

I do not ask you to do anything which I do not do, have not done. Not a year goes by that I do not personally contribute thousands of dollars to the work of CDL. But I cannot do it alone.

I do not ask you for thousands of dollars. Hundreds, if you can afford it. Even a dollar. Whatever will show your support for this great cause, this vitally important cause.

With your contribution you join hundreds of thousands of other CDL supporters, decent God-fearing people just like yourself who asked "But what can I do?" -- and who found the answer. CDL.

I most urgently invite you to begin your support of CDL by returning the enclosed contribution card today.

Every penny, every dollar will go into the fight against those who prey on the bodies, minds and souls of our children -- the predators who corrupt our young and smear their slime across the face of America.

Please -- if you've ever asked "But what can I do?" -- the answer is in front of you. I will be waiting to hear from you.

Sincerely,

Charles H Keating, Jr.

P.S. CDL's budget for the 1986-87 fiscal year is over one million dollars. Even if it were a hundred million, or a thousand miliion, it would be worth it. For if we don't continue this fight, nothing else of value will remain anyhow. Childhood innocence, family love, decency, morality -- all will be dead. All will be gone. PLEASE let me hear from you.

9ml

Q. ***Does CDL need funds and, if so, what for?***

A. CDL receives support from a few foundations, corporations and benefactors, but our lifeline is the financial support we receive from concerned citizens. The sustaining bulk of our funds comes from the individual contributions of people from across the nation.

The expenses of running an office, employing competent attorneys and staff personnel, and preparing materials and briefs for distribution are significant. Without adequate funding for CDL's dedicated personnel and necessary expenses, we will not be able to effectively counter the pornography industry.

CDL has been classified as a Section 501 (c)(3) tax-exempt organization under the Internal Revenue Code. Your gift to Citizens for Decency through Law is tax deductible.

Q. ***What active part can I take in combating pornography in my community?***

A. If you don't feel that you have the current capacity for organizing an anti-pornography drive in your community, then take time to: write to the prosecutor, judges and police officials in your community to express your concern; find out what is playing in your neighborhood theaters and what is sold in your local newsstands and drug stores; talk to your friends, talk to the merchants, and take a stand on behalf of decency.

"I'm convinced that our nation needs an organization like CDL to serve as the conduit through which the reflective conscience of our nation mounts the battle against contamination by a most pervasive disease — obscenity."

— Charles H Keating Jr.
Founder, CDL

"It is accurate to say that if CDL had not been in existence to fight . . . all the way to the Supreme Court, there almost certainly would be no controls against pornography today."

— Bruce A. Taylor, Esq.
CDL General Counsel

For more information, please write or call:

CITIZENS FOR DECENCY
THROUGH LAW, INC.
11000 North Scottsdale Road
Suite 210
Scottsdale, Arizona 85254
(602) 483-8787

CITIZENS FOR DECENCY
THROUGH LAW, INC.

So, you want to know more?

CITIZENS FOR DECENCY · THROUGH LAW ·

Dear Mr. Keating:

I stand behind you and the work of CDL. Continue enforcing today's obscenity laws to keep the pressure on the pornography industry. Please find enclosed my gift of:

☐ $100 ☐ $50 ☐ $25 ☐ $15 ☐ $ ________ Other

☐ Please check this box if this is your first gift to CDL. Thank you.

PLEASE RETURN THIS
CARD WITH YOUR
GIFT IN THE ENCLOSED
ENVELOPE. THANK YOU
FOR YOUR SUPPORT.

```
******************** 5-DIGIT 94612
00128/0010                          A273AK
Ms. Alice Gallagher
1736 Telegraph Road
Oakland, CA  94612
```

Please make your check payable to: **CITIZENS FOR DECENCY THROUGH LAW, INC.**
Your gift is TAX DEDUCTIBLE. 11000 N. Scottsdale Rd., #210, Scottsdale, AZ 85254

Q. *What is Citizens for Decency through Law?*

A. Citizens for Decency through Law (CDL) is the oldest and largest nonprofit anti-pornography organization in the United States. It was founded in 1957 by Charles H Keating Jr. who began the legal battle in Cincinnati, Ohio. CDL has worked untiringly towards its ultimate goal of the total elimination of materials that violate the nation's obscenity laws.

Q. *Why is there a need for such an organization?*

A. Pornographers use their billion-dollar profits to hire full-time lawyers who defend them in court battles against the undermanned and inexperienced staff of a local prosecutor. CDL attorneys provide the prosecution with specialized expertise in the intricacies of obscenity law. CDL helps gather evidence, prepare cases, and may even appear in court on the side of the prosecution. The CDL staff is well-equipped to carry the fight into the chambers of the United States Supreme Court, and has done so on numerous occasions.

Q. *How can a central group of legal experts work with thousands of prosecutors?*

A. In addition to direct, personal assistance, the CDL legal staff originates and disseminates information with important and far-reaching results. They regularly: prepare and mail comprehensive analyses of developments in obscenity law to the nation's prosecutors; prepare and distribute current legal briefs, as well as suggestions on the preparation and pursuit of effective prosecutions, develop new legal approaches to the problem of obscenity, bring actions, on behalf of CDL, in order to test and perfect strategies.

Q. *Aren't obscenity laws in violation of the First Amendment?*

A. Pornographers often confuse the public by claiming First Amendment immunity. Their battle cry is "freedom of the press." Yet, in over 200 years of its existence, the United States has never legalized pornography. The U.S. Supreme Court has consistently and clearly stated that obscenity is not protected under the Bill of Rights. In the 1973 ***Miller v. California*** decision, it stated, "This much has been categorically settled by the Court . . . obscene material is unprotected by the First Amendment."

Q. *Is CDL involved only in the legal area?*

A. As stated earlier, CDL's ultimate goal is the total elimination of materials that violate the nation's obscenity laws. To achieve this, its two main objectives are to demand law enforcement and to inform the public of the extent and devastating effects of pornography. In pursuing the educational objective, CDL distributes a number of tools produced by staff members — brochures, pamphlets, slide presentations and its monthly newsletter, ***The CDL Reporter.*** It regularly distributes information to local groups enabling them to take effective steps to combat pornography in their own communities.

In addition, CDL provides speakers to interested organizations and is frequently represented on panels at leading universities, as well as local and national talk shows. Many national publications have featured CDL, including lead articles in the ***Reader's Digest.***

Q. *Who is Charles H Keating Jr.?*

A. Keating is the founder and guiding spirit of the CDL organization. He is the father of six children, and the recipient of numerous awards for his humanitarian work in the pursuit of the cause of decency. Keating has traveled extensively on behalf of CDL, authored several articles for national publications and appeared on nationwide broadcasts. From 1969 to 1970, Keating was a member of the President's Commission on Obscenity and Pornography and the author of a strong dissent to recommendations of the Commission. Mr. Keating's position was adopted by the President and by the U.S. Senate, which rejected the majority recommendation by a vote of 60-5.

Q. *Exactly what are the numbers involved in today's pornography industry?*

A. ***Gross Sales:*** Pornographers have put modern technology to use. They market their trade with a multi-media approach including printed materials, slides, video cassettes and video discs, live sex shows, films and the manufacture of sexual devices. Electronic pornography is growing with the aid of the telephone, cable and subscription television and the home computer. The pornography industry generates an estimated $8 billion every year.

Outlets: In the United States, there are an estimated 900 hard-core theaters and drive-ins. There are another 15-20,000 "adult" bookstores and video cassette outlets carrying X-rated films, sex shows and devices. Added to that are thousands of convenience, grocery and drug stores, hotel/airport shops and newsstands carrying pornographic materials.

Child Pornography: Approximately 7% of the U.S. pornography market deals with sexual activity between children and other children and adults. There are at least 260 "kiddie porn" magazines being sold in adult bookstores around the country and hundreds of motion pictures showing children involved in actual sexual performances. Children are also featured in still photos sold as singles, paperback books, slides and videotapes. As many as 120,000 children are involved each year in pornography and/or prostitution.

Three Ways to Learn More

As part of CDL's educational program, your gift entitles you to receive:

1 CDL Fact Sheet. A quick overview outlining the problem, the Law, CDL's history, goals and objectives.

2 Q & A. A 14-page booklet designed to answer the most frequently asked questions about CDL's fight against pornography.

3 The CDL Reporter. CDL's monthly publication includes timely articles on the legal fight against obscenity and methods available to individuals/neighborhood groups to combat pornography in their communities. Your gift will bring The CDL Reporter to your mailbox every month!

One of the key ingredients in our successful fight against pornography is an educated public! CHK

LW

IN

- Foreign governments and overseas health manpower training institutions.
- Community foundations

In 1983, the Western Consortium was formally endorsed by the California and Hawaii State Legislatures as an appropriate and valuable source of technical assistance for state agencies and departments.

To receive more information about the Western Consortium and specific programs it has conducted, please call or write:

Joseph M. Hafey, MPA
Executive Director
Western Consortium for the
Health Professions
703 Market Street, Suite 535
San Francisco, CA 94103

telephone: (415) 546-7601
telex: 176-414 WESCONSORT
SFO

Non-Profit Organization
U.S. Postage
PAID
San Francisco, CA
Permit No. 13364

Western Consortium for the Health Professions
703 Market Street, Suite 535
San Francisco, CA 94103

WESTERN CONSORTIUM FOR THE HEALTH PROFESSIONS

N2

MISSION AND PHILOSOPHY

The Western Consortium for the Health Professions is a nonprofit corporation sponsored by the Schools of Public Health, and related continuing education programs, at the University of California campuses at Berkeley and Los Angeles and the University of Hawaii. The agency operates with the conviction that the critical health problems of the world are most effectively solved through the combined efforts of the practitioner and academic communities. Thus, the Western Consortium serves as a mechanism to bridge:

- the expertise and long term institutional commitments of the universities;
- the skills of innovators and practical problem-solvers throughout the health and development sectors; and
- the management efficiency and flexibility of a sophisticated, nonprofit service agency.

Experts available through the Western Consortium are pragmatic, productive, policy-oriented and primarily concerned with strengthening the capacity of client organizations. As an agency, the Western Consortium is dedicated to balancing concerns for cost, equity and quality in pursuing improved health status and health delivery systems.

ORGANIZATION AND MANAGEMENT

The Western Consortium was incorporated in 1975 by the Regents of the Universities of California and Hawaii. It is governed by a Board of Trustees which includes:

Roger Detels, M.D., M.S., President
Dean, School of Public Health
UCLA

Jerome Grossman, Ph.D., Vice President
Professor, School of Public Health
University of Hawaii

Leonard Freedman, Ph.D.
Secretary-Treasurer
Dean, University Extension Division
UCLA

Lawrence Hart, M.D., MPH
Director of Health Services
County of Santa Barbara, California

Joyce Lashof, M.D.
Dean, School of Public Health
U.C. Berkeley

Jerrold M. Michael, Sc.D., Dr. P.H.
Dean, School of Public Health
University of Hawaii

Henrik Blum, M.D., MPH
Professor, School of Public Health
U. C. Berkeley

Beverlee Meyers, MPH
Professor, School of Public Health
UCLA

The Western Consortium is managed by an Executive Director, who is supported by a multi-disciplinary core staff of program managers and technical experts. Faculty are involved in Western Consortium activities through a variety of mechanisms, including:

- providing direct technical assistance to the field;
- conducting on-site assessments of project operations;
- participating in conferences, workshops and other educational events;
- developing training materials;
- authoring Western Consortium publications;
- conducting research; and
- participating on the Board of Trustees and campus advisory committees.

SERVICES AND CLIENTS

Drawing upon its unique constellation of resources, the Western Consortium provides a multiplicity of services, including:

- technical assistance
- technical information and reference services
- policy analysis and research
- planning for health, health care and health manpower
- organizational and management consultation
- program and policy evaluation
- design and implementation of professional training and continuing education programs
- development of publications and educational materials.

The Western Consortium carefully tailors its resources and capabilities to meet the needs of each client. Programs can be organized within any of the disciplines represented by the member Schools of Public Health, including: health planning, policy and administration; maternal/child health and family planning; nutrition; environmental and occupational health; health education and training; demography and biostatistics; immunology; and epidemiology.

A partial listing of the Western Consortium's clients includes:

- U.S. Department of Health and Human Services
- World Bank
- Federally-funded community clinics
- Environmental Protection Agency
- United Nations Development Programme and Fund for Population Activities
- State and County Health Departments

cont. . . . . .

N3

SOPHE'S MAJOR GOALS

In 1975, the SOPHE Board of Trustees and the Society's Chapters collaborated on the development of major goals to be worked toward for the rest of the decade. Some of these goals are:

- To determine the relevance of national health legislation to SOPHE concerns
- To influence health policies and programs in which there should be an identifiable health education component
- To stimulate research in health education programs and methods, including evaluation
- To develop standards for the professional preparation and practice of health education
- To encourage high quality practice through professional development, continuing education, and training
- To assure that a mechanism for credentialing health educators exists and that it is properly used
- To increase career opportunities for health educators
- To maintain effective liaison with other organizations having allied interests in health education
- To improve communication with Chapters and members on critical issues that affect health education
- To provide guidance and support for Chapter development and expansion

SOPHE'S CODE OF ETHICS

To guide professional behaviors of its members toward highest standards, SOPHE adopted a Code of Ethics in 1976, and acknowledged the need for periodic review and improvement of the Code.

- I will accurately represent my capability, education, training, and experience, and will act within the boundaries of my professional competence
- I will maintain my competence at the highest level through continuing study, training, and research
- I will report research findings and practice activities honestly and without distortion
- I will not discriminate because of race, color, national origin, religion, age, sex, or socioeconomic status in rendering service, employing, training, or promoting others
- I value the privacy, dignity, and worth of the individual, and will use skills consistent with these values
- I will observe the principle of informed consent with respect to individuals and groups served
- I will support change by choice, not by coercion
- I will foster an educational environment that nurtures individual growth and development
- If I become aware of unethical practices, I am accountable for taking appropriate action concerning these practices

Q1

SOCIETY FOR PUBLIC HEALTH EDUCATION, Inc.
703 MARKET STREET • SAN FRANCISCO, CA 94103 • (415) 546-7601

MEMBERSHIP APPLICATION

Membership Eligibility

☐ **Active Fellow**

A health educator who meets one or more of the following criteria:

1. A professional with a graduate or undergraduate degree from a formal health education program.
2. A professional who is employed or is functioning in a health education capacity.
3. A faculty member of a health education program.
4. An individual with an undergraduate degree from a program approved by SOPHE, or a school accredited by the Council on Education of Public Health.

☐ **Student Member**

A person who is enrolled full-time in a health education program. Applicants for student membership must be sponsored by an Active Fellow. The application must be accompanied by a statement from a faculty member attesting to the full-time student status and the expected date of graduation.

Areas of Special Interest
(Please indicate TWO of highest priority)

A. ________ Medical Care Settings/ Patient Education
B. ________ School Health Education
C. ________ Community Health Education
D. ________ Workplace Health Education
E. ________ International Health Education
F. ________ Mass Media & Technology Based Education
G. ________ Other Special Interest: ________________

If you have paid Student Fee, please list your date of graduation: ________________

Name: ________________
(PLEASE PRINT)
____
(TITLE)
____
(ORGANIZATION)
____
(STREET)
____
(CITY) (STATE) ZIP

Preferred Mailing Address:
____
____
____
____

Phone (H) ( ) ________________
(W) ( ) ________________

Are you a member of a local SOPHE Chapter? Yes ________ No ________
If yes, please name Chapter: ________________

To promote, encourage and contribute to the advancement of the health of all people through education.

(Rev. 10-85)

What Is A Public Health Educator?

Why do people suffer from illness that could be prevented? Why do they fail to behave in a way that will promote good health? Why, in short, doesn't everyone use the health knowledge available? These questions concern every health worker. The health educator, though, is a specialist on the health team who diagnoses these problems from an educational point of view and helps to solve them through the selection and use of sound educational methods tailored to particular educational needs.

Sometimes it is simply a lack of information which keeps the public from taking needed health action. When this is the case, it is the job of the health educator to translate scientific achievements into everyday usable form. Health education of this type is as old as health knowledge, and every health worker shares responsibility in spreading that knowledge and getting it used. The health educator helps each health professional do this part of his job better, however, by teaching his colleagues to recognize educational needs and potentials in various situations and the effective use of educational methods. In addition, as a specialist in the techniques of getting health facts accepted and used, the health educator works closely with all kinds of community groups who are interested in health projects and programs.

Still, facts alone are not always the answer. The social sciences have shown clearly that human behavior is affected by a multitude of forces in addition to knowledge. Applying insights from psychology, sociology, and anthropology, the health educator analyzes the reasons people might not be following good health practices and organizes intensive, well-planned health education programs to remedy the problem. Skills in many fact-finding techniques, such as interviewing, surveys, and community study, help in this process. The people who need education, however, are the most valuable resources: for they, more than anyone else, know what is important to them and why. Then too, being involved in fact-finding is educational in itself! The health educator knows that people learn by thinking through their own problems.

A basic tenet of the public health educator is that final decisions about health practices must be made by the individuals involved. Nevertheless, there is a responsibility to provide access to sources of information and experiences needed by the individual in relating desirable health practices to motives, goals, aspirations, and values.

The health educator serves as a psychological stage-setter stimulating people in the community to recognize health problems of which they may be unaware and to work for their solution. Such problems might have to do with pollution of the environment, chronic disease, overpopulation, drug abuse or any of hundreds of ills which plague our society today.

Depending upon the situation, the health educator is prepared to use very different methods of communication. Expertise is needed in a variety of individual, group, and community education approaches, as well as knowing which educational media and materials can be used most effectively. Helping a group create its own educational materials is an experience which often leads to greater learning than could ever result from exposure to the most polished professional teaching aids.

Sometimes, the problems in taking health action lie not with the community, however, but with the people *providing* health services. The health educator also has an important role to play in helping other health personnel plan and deliver health care in ways which the community can and will use. Skills in education and communication are required just as much to teach professionals how the community feels about health as to teach the community what professionals *know* about health.

Frequently, improving health care involves training for health workers who need to keep abreast of new knowledge in their own professional disciplines through continuing education, for young people entering new health careers, for neighborhood health aides who will help to improve health communications among the poor, for citizen volunteers who are ready to assume new community leadership. Here again, the health educator can contribute to better health by consulting on the development of training programs, by suggesting creative methods, and even by training the trainers themselves to be better teachers.

Health educators, then are modern pioneers—seeking new understanding into human behavior, new ways to apply this knowledge in solving individual and community health problems.

Today, the requirements for becoming a qualified public health educator are more exacting than in the early development of the field, and all the signs point in the direction of strengthened professional standards. Leadership positions in the field require a Master's degree, which includes training in fundamental public health areas, such as disease control and environmental health; as well as in-depth preparation in educational theory and methods; analysis of health education problems, and educational program planning all designed to help the health educator function effectively in the midst of health and social change. Most Master's degrees in public health education are offered by schools of public health, although a few universities without such schools have recently been accredited to provide such training. Information regarding scholarships and financial aid should be secured from the school at the time of application.

Another recent development is that an increasing number of colleges and universities are offering a Bachelor's degree in community health education. These programs, with instruction in the biological and social sciences and basic health education skills, prepare the student for many community jobs as well as for graduate study if desired. A Bachelor's degree with a blend of broad, solid courses in physiology, bacteriology, chemistry, biology, educational and social psychology, sociology, and cultural anthropology also provide the basic underpinnings needed for admission to graduate programs.

Doctoral degrees—traditionally the highest academic degree available—are also offered in public health education. Many doctoral level health educators are needed now and more will be in the future to meet rapidly growing needs for research and evaluation skills in health education and for teaching in institutions of higher learning around the world.

As you plan your own future, you should be sure to obtain information about the requirements of the schools offering the degree in which you are interested. Some schools offering the Master's degree also require a certain amount of practical work experience prior to graduate education, although the trend is to provide this as part of the school curriculum.

Q3

Nevertheless, since community experience is very helpful prior to graduate level training you should look into the opportunities. Some agencies have special paid positions for career development in health education. Getting involved in a community health project, a neighborhood health center or a hospital clinic is also a good experience for the would be health educator. Likewise all chances to develop your skills in communication and public speaking, leadership techniques in group work, community organization and educational methods should be welcomed.

OPPORTUNITIES AND PROSPECTS

Because this is a small but rapidly expanding profession, it has grown from 600 in 1950 to over 3,000 professionally trained community health educators today. Rapidly increasing scientific developments and knowledge, the initiation of new health and social programs, and the expansion of existing ones—in all of which education is a critical component—have created a need for health educators.

New positions are constantly opening for both men and women in local, state and Federal agencies, international health programs, community and regional planning councils, poverty projects, the Peace Corps, hospitals and clinics, industry, agricultural extension services, colleges and universities, and professional societies. All races and ethnic groups are needed for many of these jobs, especially where minority group membership is an asset in understanding and working with people of various cultural and ethnic backgrounds.

Although beginning salaries vary, depending on the kind of agency, its location and the level of responsibility of the position, they range from about $12,000 to $14,000. Many public health educators, who have extensive training and experience command salaries of $18,000 and higher.

••••••••••••••••••••••••••••••••••••

Education Requirements: The requirements for admission to the various schools differ but all require at least a bachelor's degree from a recognized institution with adequate preparation in education, social science and the basic health sciences. For specific information, write the school or schools of your choice, listed here.

••••••••••••••••••••••••••••••••••••

INSTITUTIONS OF HIGHER LEARNING OFFERING GRADUATE TRAINING IN COMMUNITY HEALTH EDUCATION*

*Accredited by the American Public Health Association

UNIVERSITY OF CALIFORNIA/Berkeley, School of Public Health; Earl Warren Hall, Berkeley, CA 94720

UNIVERSITY OF CALIFORNIA/Los Angeles, School of Public Health; 10833 Le Conte Ave., Los Angeles, CA 94720

COLUMBIA UNIVERSITY, School of Public Health
600 West 168th St., New York, NY 10032

HARVARD UNIVERSITY, School of Public Health
55 Shattuck St., Boston, MA 02115

UNIVERSITY OF HAWAII, School of Public Health
1960 East-West Rd., Honolulu, HI 96822

LOMA LINDA UNIVERSITY, School of Public Health
Loma Linda, CA 92354

UNIVERSITY OF MASSACHUSETTS, Dept. of Public Health; Amherst, MA 01002

UNIVERSITY OF MICHIGAN, School of Public Health
Ann Arbor, Michigan 48104

UNIVERSITY OF MINNESOTA, School of Public Health
1325 Mayo Memorial Bldg., Minneapolis, MN 55455

NEW YORK UNIVERSITY, School of Education
Washington Square, New York, NY 10003

UNIVERSITY OF NORTH CAROLINA, School of Public Health; Chapel Hill, NC 27514

CALIFORNIA STATE UNIVERSITY, Northridge; Dept. of Health Sciences; Northridge, CA 91324

UNIVERSITY OF PUERTO RICO, School of Public Health
GPO Box 5067, San Juan, Puerto Rico 00931

SAN JOSE STATE UNIVERSITY, Dept. of Health Sciences; 125 South 7th St., San Jose, CA 95114

UNIVERSITY OF TENNESSEE, College of Education
Knoxville, TN 37916

YALE UNIVERSITY, Dept. of Epidemiology & Pub. Hlth,
60 Colleges St., New Haven, CT 06510

JOHNS HOPKINS UNIVERSITY, School of Hygiene and Pub. Hlth.; 615 No. Wolfe St., Baltimore, MD 21205

UNIVERSITY OF MISSOURI, Div. of Community Hlth. Ed.
M-504 Medical Sciences Bldg., Columbia, MO 65201

HUNTER COLLEGE, Community Health Education Program, Institute for Health Sciences; 105 East 106th St., New York, NY 10029

SOCIETY FOR PUBLIC HEALTH EDUCATION, INC.

[illegible]

Q4

WHAT IS SOPHE?

The Society for Public Health Education is a national professional service organization formed in 1950 to promote the health of all people by stimulating research, developing criteria for professional preparation, and elevating performance standards for the practice of health education. Cumulative efforts by its members have helped SOPHE achieve international recognition for its outstanding contributions to the improvement of individual and community health.

Affairs of the Society are guided by a Board of Trustees, which is composed of elected officers, at-large, and Chapter members. The Board determines organizational direction, develops policies, and sets the framework for achievement by its committees and the Society's Chapters. More than 80 percent of the members belong to local Chapters.

SOPHE's membership extends health educational principles and practice into many settings: The community . . . colleges and universities . . . the home . . . hospitals and other health care facilities . . . official, professional, and voluntary health agencies and organizations . . . schools . . . and the workplace. The Society derives its strength from the united efforts of its members, who include: Administrators . . . behavioral scientists . . . community health educators . . . consumers . . . dentists . . . faculty . . health planners . . . mental health educators . . . nurses . . . physicians . . . school health educators . . . teachers . . . and volunteers.

WHAT SOPHE MEMBERSHIP OFFERS YOU

One-year subscription to *Health Education Quarterly*, SOPHE's scholarly journal

National health legislation information/action network activities

Annual Membership Directory

Chapter affiliation for regular contact and idea exchange with colleagues

Discount prices on SOPHE publication

Opportunities to achieve professional identity and recognition through service on SOPHE committees and task forces

SOPHE *News & Views*, the Society's newsletter

Long-term professional development and continuing education activities

Opportunities to influence standards for professional preparation and practice

SOPHE Annual Report

Opportunities to know other members who are active at local, state, national, and international levels

Reduced registration fees for SOPHE'S annual meeting, held each fall in conjunction with the annual meeting of the American Public Health Association

SOPHE membership benefits and services are designed to help you fulfill your health education responsibilities and increase your professional competence.

Q5

Annual Dues

Applications must be accompanied by a check or money order for the current year's dues. Your check will be held until you have been accepted as a member and notified.

Active Fellow—$50 Student—$20 Without Quarterly, $40 With Quarterly.

Educational Background

Name/Location of School	Major	Dates Attended	Degree	Date Conferred/Expected

NOTE: Applicants for student membership must include a letter from a faculty member or institutional representative certifying that they are students in good standing enrolled in an undergraduate or graduate program of health education.

Experience and Related Activities

Please describe your professional experience or participation in health education over the past two years. If you are not formally employed in health education, please describe your involvement in the field.

Sponsorship

The Society for Public Health Education requires that an applicant for membership be sponsored by an Active Fellow in good standing. If there is no sponsor available to sign this application for you, submit it to the Society without a signature. SOPHE will then locate a Fellow in your area to sponsor you.

I know (applicant)____________________and believe that (s)he is qualified for membership in the category checked. I have read this application and believe it to be an accurate statement of this individual's eligibility. As an Active Fellow in good standing, I sponsor this applicant for membership in the Society.

Sponsor's signature

Sponsor's name (Please print)

Date

For Use by the Administrative Office

Date received

Sent to committee

Action taken

Date

Signature

R1

Snelling and Snelling INC
The World's Largest Employment Service

INTERNATIONAL HEADQUARTERS • SNELLING PLAZA • 4000 SOUTH TAMIAMI TRAIL • SARASOTA, FL 33581 • (813) 922-9616

September 26, 1986

Dear White House Conference Delegate,

PRIVATIZATION - an opportunity

White House Conference final RA's

- #3-b Prohibit direct, government-created competition in which government organizations perform commercial services.
- #28-f OMB Circular A-76 be made to apply to all federal monies used directly or indirectly in provision of goods and services which are available in the private sector.
- #29-b Privatization of public services through the contracting out of sale of service and commercial operations to the private sector.

Now we have an opportunity to help privatize a service that is being provided more efficiently and effectively by the private sector even though there is direct competition from the government. **At the same time we can save an estimated 50% of our Unemployment Insurance or up to 3% of our payroll!**

The Department of Labor is going to hold a series of public hearings on the US Employment Service:

San Francisco	10/15	Atlanta	10/21
Denver	10/17	Washington, DC	10/23

Another of our final RA's can be supported at the same time:

#31 Unemployment Insurance: amend the Federal Unemployment Tax Act and the Social Security Act and the Wagner-Peyser Act to achieve the following:

a. Prohibit strikers from collecting benefits.
b. Require claimants to actively seek work and accept the next best job after eight weeks of job search or lose benefits;

R2

  c. Eliminate FUTA and related taxes on wages of persons who do not qualify for benefits, (e.g., independent contractors, corporate officers, share-holders, retirees, etc.)

  d. Allow surplus funds to be invested in the state which paid the taxes.
  e. Cap FUTA tax at present levels.
  f. The rate increase of .2% in FUTA taxes should be allowed to expire on January 1, 1988 as scheduled under current law.

You can help by:

1. Appearing at one of the hearings to give testimony.(Let us know if you'd like to do this - we wish to coordinate it).
2. Submitting written testimony directly to the Secretary of Labor (you may want to "copy" your Congressional Representative)
   Honorable William Brock, Secretary
   U.S. Department of Labor
   200 Constitution Ave., N.W.
   Washington, DC 20210
3. Communicate with other Employers in your area, letting them give input on the subject of privatization and UC reform.

We met in our states; we took the time and expense to go to Washington; we forged a list of recommendations that showed the depth of our perception in recognizing the problems in our country, but even more important offering creative solutions. Now... Let's MAKE IT HAPPEN - Let's utilize this opportunity to publicly support our recommendations.

Today let's:
1. Indicate our willingness to testify.
2. Write the Secretary of Labor
3. Enlist others.

If you have a question, please call 1-(800)-237-9497, or write my office. If I'm unavailable ask for Lee Coppock.

Have a great day!

Yours for stronger business - which means a stronger America,

Robert O. Snelling, Sr.

Robert O. Snelling, Sr.
Chairman of the Board

R3

MAJOR GOALS - STATE EMPLOYMENT SERVICE RESTRUCTURING

I Privatization

- A. Voucher System for UC recipients to use Private Sector Employment Services. Payment to come from state U. I. funds.
- B. Referral of all other applicants to PSES on fee paid jobs.
- C. Eliminate SES activities in competition with PSES (placing employed, running Personnel Departments, testing, advertising etc.)

Based on OMB circular A-76 and White House Conference on Small Business recommendations 3-b, 28-f and 29-b.

II U. C. Reform: Amend Wagner-Peyser Act

- A. Enact White House Conference on Small Business Recommendation #31
  - a. Prohibit strikers from collecting benefits.
  - b. Require claimants to actively seek work and accept the next best job after eight weeks of job search or lose benefits;
  - c. Eliminate FUTA and related taxes on wages of persons who do not qualify for benefits, (e.g., independent contractors, corporate officers, share-holders, retirees, etc.)
  - d. Allow surplus finds to be invested in the state which paid the taxes.
  - e. Cap FUTA tax at present levels.
  - f. The rate increase of .2% in FUTA taxes should be allowed to expire on January 1, 1988 as scheduled under current law.

- B. Standardize rules and regulations for all states
  - 1. Who is entitled to U. C. benefits?
  - 2. Duration and amount of U. C. benefits.
  - 3. Work Test to be enforced equally.

III Prioritize S.E.S. Activities

- A. Find jobs for U. C. recipients.
- B. Find jobs for unemployed.
- C. Refer U. C. recipients and other unemployed to JTPA or other training/counselling services.
- D. Stop Fraud by employers, government and unemployed.

R4

THE WALL STREET JOURNAL

© 1986 Dow Jones & Company, Inc. All Rights Reserved

★ Eastern Edition FRIDAY, SEPTEMBER 5, 1986 Orlando, Florida

Job Agency That Expects Employer to Call

By James Bovard

Recent studies found that private employment agencies can place a significantly higher percentage of welfare recipients in jobs than can the federally funded State Employment Services (ES). But according to a March General Accounting Office study, ES employees refuse to refer low-income clients to private agencies—primarily because they fear they eventually would put themselves out of work. This is a classic case of government workers holding poor people hostage in order to preserve their own inefficient jobs.

The GAO found that in Texas and Pennsylvania, ES did not have listings for the majority of the jobs private agencies found for welfare recipients. The GAO report cited an estimate from the National Association of Personnel Consultants that the NAPC could place a quarter of all ES referrals, thus decreasing welfare payments, unemployment compensation and food-stamp payments, and boosting tax revenue from employed workers.

But the Employment Service fiercely resists any invasion of its turf or any meddling with its unemployed registrants.

The U.S. Employment Service is a $740 million program that distributes federal dollars raised from employers through the Federal Unemployment Tax Account to ES agencies. Founded in 1933, it functions as a labor exchange and—in many states—a means to insure that welfare, food-stamp and unemployment-compensation recipients are actually looking for work.

But ES dismally fails at its enforcement function. In 1976 only 1% of those receiving unemployment compensation had benefits cut off for refusal to work. (The Labor Department no longer bothers keeping statistics on this.) The work requirement is a joke because of ES negligence and lack of coordination between ES and Unemployment Insurance offices.

It is a little difficult to tell what the ES is doing now—partly because its most recent available statistics are for fiscal 1983. For that year, ES claims there were 15 million applicants and three million placements, for a batting average of 20.3%.

But ES is notorious for cooking its books. In a 1977 study, GAO found that ES exaggerated the number of its placements by 75%. ES claimed 1.9 million "long-term placements" of 150 days or longer for 1983. But a Labor Department inspector general report found that only one-third of reported long-term placements actually stayed on the job for 150 days. ES often places the same person in short-term jobs many times during a year.

Some advice rendered by local ES agencies is worse than useless. The Washington, D.C., Department of Employment Services distributed a booklet to school-age youth on how to get a job. Included was a sample application letter that read: "I would appreciate the opportunity for an interview. . . . May I come to the store after school Monday, October 11? Please telephone me at 227-4810 to confirm the appointment. I am at home after three o'clock on school days."

The folks at D.C. Employment Services have been working for the government too long. The arrogance of appointing a time for an appointment (and then telling an employer whom the youth has never met to call and confirm it) would be laughable—except that this advice is being given to tens of thousands of naive job seekers.

The 1982 Job Training Partnership Act (JTPA) required ES to create a nationwide job bank. But last year barely 5,000 applicants across the country found jobs through this new program. Much of the information listed in the national job bank is hopelessly out of date—partly because some states rely on the Postal Service to distribute their job information.

ES duplicates placement branches in other government programs, such as JTPA, the Job Corps, vocational-education programs, and welfare programs. Poor people often are not hired because of lack of coordination between various public programs. A 1982 Labor Department-funded study found that people who got jobs through ES got lower-paying jobs than they would have found on their own (though they sometimes found jobs faster through ES).

Though ES apparently lacks the time or ability to find jobs for low-income people, it is increasingly trying to become a placement service for higher-paying, more skilled and more prestigious professionals. It is aggressively advertising and trying to sign up currently employed accountants, doctors and engineers. In order to boost its statistics it is becoming an on-site hiring hall for corporations. At a recently opened General Motors plant in Missouri, ES set up shop and screened 20,000 job applications, gave more than 10,000 tests and helped find 2,500 workers for the auto maker. And at the Mark Plaza hotel in Alexandria, Va., ES set up shop on-premises to fill the hotel's hiring needs. Should the government be paying for routine corporate operating expenses?

Since ES was founded, private labor exchanges have greatly expanded. With the advent of cheap computers and data banks it would be easy to run a community job bank with no federal aid. A single clerk manning a phone and punching into a keyboard could easily maintain such a job bank. The central data base could be accessible by computer monitors to welfare and food-stamp offices, county court buildings or any private business. In the majority of cases this would provide as good service as or better service than ES currently provides, at a fraction of the cost.

As for the low-income people who cannot find jobs on their own, the first thing to do is to remove the incentives to be unemployed. As long as it is easy for able-bodied people to get paid for not working, any work test will be a farce.

There probably will be a small number of people who lack skills or the ability to find jobs on their own. Instead of a federal program that helps the poor at its leisure, it would make more sense to have a voucher system, giving bonus payments to private employment agencies for each hard-to-place welfare or low-income person they place in jobs.

Poor people should not be kept out of jobs so that government clerks can draw salaries for shuffling paper in their behalf. ES is another example of the government doing badly what it shouldn't be doing at all.

Mr. Bovard is a free-lance writer in Washington.

BCR1

Blue Cross
and
Blue Shield
SERVICE BENEFIT PLAN

Dear Subscriber:

The Blue Cross and Blue Shield Service Benefit Plan is pleased to announce new coverage for prescription drugs under the Mail Order Prescription Drug Program. Beginning in January 1987, you will be able to order prescription drugs through National Rx Services, the mail order pharmacy that will be filling your prescriptions. The program is designed as a convenient, low-cost alternative for people who use prescription drugs on an on-going basis.

In order to get started using the program, enclosed are the following:

- **Mail Order Pamphlet,** prepared by National Rx Services Inc. which describes their services in detail and how to use them. Please read this pamphlet carefully and follow the instructions for ordering your first prescription.
- **Patient Profile Questionnaire,** which is attached to the Mail Order pamphlet. You will only need to fill out the Patient Profile Questionnaire once. National Rx Services Inc. will keep this information on file to better serve you.
- **Order Envelope,** which has been pre-addressed and postage paid for your convenience.

If you do not use this optional mail order program, we will continue to pay for your prescription drugs as we have in the past. If you have High Option, your prescriptions will be reimbursed at 80% after your annual deductible has been met. Standard Option subscribers will be reimbursed at 75% after your deductible is met.

If you have any questions about this new Mail Order Prescription Drug Program or need further help, you may contact the customer service department at National Rx Services by calling 1-800-262-7890.

Sincerely,

James N Gillman

James N. Gillman
Vice President

Announcing a new

MAIL ORDER PRESCRIPTION DRUG PROGRAM

Rx

a convenient new program designed to save you money and time

Offered By
NATIONAL Rx SERVICES, INC.
for Subscribers of
The Blue Cross and Blue Shield Service Benefit Plan

WHAT IS THE DIFFERENCE BETWEEN GENERIC AND BRAND NAME DRUGS?

The generic name of a drug is its chemical name The brand name is the trade name under which the drug is advertised and sold By law generic and brand name drugs must meet the same standards for safety purity strength and effectiveness When your doctor prescribes generically or authorizes generic substitution it permits us to dispense a generic drug So whenever possible, ask your doctor to prescribe generic drugs

HOW WILL MY ORDER BE HANDLED?

When you order by mail your prescription is reviewed by one of our registered pharmacists checked against your Patient Profile dispensed and verified by another registered pharmacist before we mail it to you

IF YOU NEED HELP OR HAVE ANY QUESTIONS

Contact our Customer Service Department Monday through Friday from 8 00 A M to 8 00 P M eastern time

TOLL FREE NUMBER: 1-800-262-7890

The submission of your prescription (or those of family members covered by the plan) constitutes full consent and express authorization to National Rx Services Inc to release all information pertaining to the enclosed prescription(s) to the plan administrator underwriter, sponsor, policyholders, and the employer

National Rx Services, Inc
P O Box 30491
Tampa, FL 33634

A Subsidiary of MEDCO Containment Services Inc

DETACH ALONG DOTTED LINE

COMPLETE and MAIL WITH FIRST ORDER

Please complete the information below for every covered family member. If anyone has any allergies, any chronic diseases or is sensitive to any drug or drugs, please list below. If no one has allergies, chronic diseases or sensitivities, please check "none" in the box and sign below

NAME ____________ RELATIONSHIP ________ DATE OF BIRTH ________ SEX ______
DESCRIBE CONDITION ______________________________ ☐ NONE
NAME ____________ RELATIONSHIP ________ DATE OF BIRTH ________ SEX ______
DESCRIBE CONDITION ______________________________ ☐ NONE
NAME ____________ RELATIONSHIP ________ DATE OF BIRTH ________ SEX ______
DESCRIBE CONDITION ______________________________ ☐ NONE
NAME ____________ RELATIONSHIP ________ DATE OF BIRTH ________ SEX ______
DESCRIBE CONDITION ______________________________ ☐ NONE

SUBSCRIBER'S SIGNATURE ______________________

Listed below are 25 of the most commonly prescribed brand name drugs and their generic equivalents If you take any of these brand name medications, you may ask your doctor to approve the generic equivalent by indicating the generic name on the prescription

Brand Name	Generic Equivalent
Aldactazide	Spironolactone/Hctz
Aldomet	Methyldopa
Aldoril	Methyldopa Hydrochlorothiazide
Apresoline	Hydralazine
Ativan	Lorazepam
Catapres	Clonidine
Dalmane	Flurazepam
Darvocet-N	Propoxyphene Napsylate/APAP
Diabinese	Chlorpropamide
Elavil	Amitriptyline
Enduron	Methyclothiazide
Hydrodiuril	Hydrochlorothiazide
Hygroton	Chlorthalidone
Inderal	Propranolol
Indocin	Indomethacin
Isordil	Isosorbide Dinitrate
Lasix	Furosemide
Motrin	Ibuprofen
Norpace	Disopyramide
Persantine	Dipyridamole
Reglan	Metoclopramide
Robaxin	Methocarbamol
Tolinase	Tolazamide
Valium	Diazepam
Zyloprim	Allopurinol

BCR2

WHAT IS THE MAIL ORDER PRESCRIPTION DRUG PROGRAM

The Mail Order Prescription Drug Program is an alternative to your current prescription drug benefits. It is ideal for those of you who take prescription medications on an ongoing basis because it offers several advantages:

- **Low costs**: You pay only one copayment per prescription: **High option = $3.00; Standard Option = $5.00**. Copayment does not apply to subscribers with Medicare B.
- **No claim forms** to file.
- **No waiting** for reimbursement.
- **Convenience** of home delivery.
- **Large quantities**: You can receive up to a 90 day supply of medication at one time (see "HOW CAN I RECEIVE A 90 DAY SUPPLY OF MEDICATION?").
- **Toll free** customer service number.

WHO IS ELIGIBLE?

Subscribers enrolled in the Blue Cross and Blue Shield Service Benefit Plan (SBP) High or Standard Option. This includes the contract holder and all covered family members.

WHAT IS COVERED?

Maintenance prescription medications currently covered by High and Standard Option.

WHAT IS MY COST?

Subscribers with High Option pay $3.00 per prescription. Subscribers with Standard Option pay $5.00 per prescription. Subscribers covered under Medicare B pay nothing. The copayment is paid for each prescription and refill of that prescription.

WHAT ABOUT EMERGENCY SITUATIONS?

Obviously, there will be times when you need a prescription immediately. On these occasions, you should have your prescription filled at a local pharmacy. If you need medication immediately **but will be taking it on an ongoing basis**, ask your doctor for 2 prescriptions: the first should be for a 14 day supply that you can have filled at a local pharmacy; the second prescription should be for the balance, up to a 90 day supply. Send the larger prescription along with your copayment to us immediately.

© National Rx Services Inc 1987

HOW DO I USE THIS PROGRAM?

1. Ask your physician to prescribe needed medications for up to a 90 day supply (minimum 21 day supply) plus refills. If you are presently taking medication, ask your doctor for a new prescription.
2. Complete the attached Patient Profile Questionnaire with your first order only. Be sure to answer all the questions, and make certain you include the subscriber's SBP ID # (R . . .) on the form.
3. Send the completed profile card, your original prescription(s) and the appropriate copayment for each prescription to us.
4. We will process your order and return your medications to you via First Class Mail (or when required by UPS), along with instructions for future refills. Please allow up to 14 days for delivery from the time you mail your prescription to us.

HOW DO I ORDER REFILLS?

With your original prescription medication, you will receive a notice showing the number of times it may be refilled. Simply mail this refill notice with your copayment for each prescription and mail to us in the postage paid pre-addressed order envelope (which has been provided). To avoid the risk of running out of medication, order your refills two weeks before you need them.

HOW CAN I RECEIVE A 90 DAY SUPPLY OF MEDICATION?

Your doctor must prescribe a 90 day supply for you to receive that quantity. For example, if you take one tablet per day, your doctor must write a prescription for 90 tablets. If you take two tablets per day, your doctor must write a prescription for 180 tablets. If you take three tablets per day, your doctor must write a prescription for 270 tablets, etc. The law requires that pharmacies dispense no more than the quantity prescribed by the physician. If your doctor authorizes refills, they can only be dispensed when your initial order has nearly expired, so be sure to ask your doctor to prescribe a 90 day supply, plus refills, whenever appropriate. **Please note: Certain controlled substances are subject to quantity limitations.**

HELPFUL HINTS

To ensure prompt processing of your order, check your prescriptions before you leave your doctor's office to make sure that:

- The doctor's name is legible.
- The exact daily dosage is indicated.
- The exact strength is indicated.
- The exact quantity is indicated.
- The full first and last names of the patient for whom the medication was prescribed are legible.

Although we normally ship your prescription to you within 48 hours of receipt, **please allow 14 days for delivery from the date you mail your prescription order.** All orders are sent via First Class Mail (or if required, by UPS) but allowing ample time will help you avoid the chance of running out of medication.

DETACH ALONG DOTTED LINE

PATIENT PROFILE QUESTIONNAIRE

COMPLETE and MAIL WITH FIRST ORDER

NATIONAL Rx SERVICES, INC. • P.O. BOX 30451, TAMPA, FL 33614

IMPORTANT: Please complete both the front and back for you and other members of your family covered under the Service Benefit Plan. Be sure to describe any allergies, chronic diseases or sensitivities to any drug(s). If no one has any allergies, chronic diseases or drug sensitivities, please check "none" in the box and sign below. **PLEASE PRINT OR TYPE.**

Subscriber ID # as it appears on your Service Benefit Plan ID Card: R 0 1 1 3 0 0 0 6

Enrollment Code: FEP 1 0 4

SUBSCRIBER NAME ALICE P. GEIDE

ADDRESS 17619 WICKMAN CT CITY SAN LORENZO

STATE CALIF ZIP 94580 Daytime Telephone 415 278-4823

DATE OF BIRTH 10-20-17 SEX FEMALE

DESCRIBE CONDITION HYPCXEMIA EMPHYSEMA

☒ NONE

Please complete other side

Subscriber Signature Alice P. Geide

DETACH ALONG DOTTED LINE

Please Present this Portion

TO YOUR PHYSICIAN

Dear Physician:

Your patient is eligible to participate in a **mail order maintenance prescription drug program** which permits up to a **90 day supply** of medication when so prescribed by you. Refills, when authorized by you, are permitted to a maximum of one year except where prohibited by law.

We request your cooperation in prescribing **generic drugs** whenever possible, and medication quantities to the plan's 90 day maximum when appropriate. **This request is not intended to compromise your judgment, nor is it a request to order medication that will not be used.**

Example: If a patient takes one tablet a day, please write for the exact quantity of 90 tablets with three refills. . . two daily, prescribe 180, etc. Please specify the exact quantity you wish. When applicable, please include your DEA number and either use a form showing your name clearly or print your name. Please include daily directions, proper strengths, the exact number of refills, and **generic names of the medication.**

If you have any questions concerning this program, please contact the Pharmacy's Customer Service Department, Monday through Friday, from 8:00 A.M. to 8:00 P.M. eastern time. Toll Free Number: 1-800-262-7890.

THANK YOU FOR YOUR COOPERATION
National Rx Services, Inc.

BCR4

INSTRUCTIONS:
1. COMPLETE ALL INFORMATION
2. ENCLOSE PRESCRIPTION(S) OR REFILL LABEL(S).
3. ENCLOSE $5.00 COPAYMENT.
4. IF YOU HAVE MEDICARE B NO COPAYMENT IS NECESSARY BUT YOU MUST INCLUDE MEDICARE NUMBER
5. SEAL AND MAIL

The submission of your prescription (or those of family members covered by the plan) constitutes full consent and express authorization to National Rx Services, Inc. to release all information pertaining to the enclosed prescription(s) to the plan administrator, underwriter, sponsor, policyholders, and the employer.

PATIENT'S CORRECT NAME, ADDRESS AND AGE MUST APPEAR ON EVERY PRESCRIPTION.
ENCLOSE YOUR PRESCRIPTION AND/OR REFILL LABELS

IF YOU NEED HELP OR HAVE ANY QUESTIONS
CONTACT NATIONAL'S CUSTOMER SERVICE DEPARTMENT.

SPECIAL TOLL FREE NUMBER 1-800-262-7890

PLEASE COMPLETE THE ENTIRE FORM AND PRINT CLEARLY

Subscriber ID # as it appears on your Service Benefit Plan ID card.

Enrollment Code

SUBSCRIBER NAME ____________ R ☐☐☐☐☐☐☐☐ FEP 1 0 ☐

ADDRESS ____________ CITY ____________ STATE ________ ZIP ____________

DR. NAME ____________ DR. PHONE NO. (______) Area Code ____________ YOUR DAYTIME PHONE NO. (______) Area Code ____________

☐ CHECK HERE IF WE MAILED YOUR LAST PRESCRIPTION TO A DIFFERENT ADDRESS THAN SHOWN ABOVE.

Please fill out all of the information requested below for each family member sending a prescription in this envelope.

	NAME OF PATIENT(S)	BIRTHDATE			PATIENT IS					Covered Under Medicare B		If Yes Furnish Medicare #
		Mo	Day	Year	Self	Spouse	Child	Male	Female	Yes	No	
1.												
2.												
3.												
4.												

I represent that I am eligible to participate in the plan and that all prescriptions contained in this order are for me or another subscriber(s) in my family covered under the plan. If the doctor has not required a brand name, I approve dispensing the prescription(s) with a generic equivalent.

NUMBER OF PRESCRIPTIONS ENCLOSED ______ × ______ $5.00 Copayment = $ ______ Amount Enclosed

Payment is being made by ☐ Cash ☐ Check ☐ Money Order

____
Subscriber Signature

Now
Progressive Door Prize

HAPPY FATHER'S DAY

Good Neighbors Played on Reg. Games Except Blackout

NOW ALL PAPER **Every Friday**

CONCORD HIGH BAND BOOSTERS BINGO

4200 CONCORD BLVD., CONCORD

DOORS OPEN 6:00 PM - FIRST GAME 7:00 PM

Door Prizes Nightly

PULL TABS — SNACK BAR — U PICK-EM
FREE COFFEE & POPCORN
ECONO PACKS AVAILABLE

One Free U-Pick-Em
One Per Person
June Only

One Free Night Owl
Pack
June 26th
One Per Person

**$250.00 Blackout
Guaranteed
Early Bird Pots
Guaranteed**

BINGO
FREAK

Mike and Mauia Laurella play on Friday nights at St. Raymond's in Dublin.

Marty and Don Church play at the Hanger in San Ramon. They have moved their Bingo from Friday nights to Monday nights.

GOOD FELLOWSHIP SENIORS Bingo

**Every Saturday - Doors Open at 5:00 p.m. - Game Starts at 6:30 p.m.
Every Sunday - Doors Open at 11:00 a.m. - Game Starts at 12:30 p.m.**

FEE SCHEDULE: Single Pack $17 - Double Pack $25 - Triple Pack $30 - Four Pack $35

Saturday & Sunday Schedule - 20 Games
(Not 18, But 20)

**All Regular Games Pay $250.00
Nightly $5,500.00 Payout
Bonanza Special $250.00 Bonus Bingo Special**

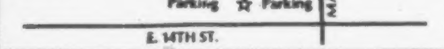
Last Saturday & Last Sunday of Each Month - Spectacular Door Prizes
Save Your Admission Ticket

Wheel of Fortune - 3 Prizes Each Session Including a Two People Overnight Reno Package, $100.00 - $75.00 - $50.00 - *Plus More!*

NOW — PROGRESSIVE UP $100.00 PER WEEK UNTIL WON

Warm Ups, 5 Game Pack For $1.25 - Pays $50.00 Per Game

JUNE 21ST - FATHER'S DAY SPECIAL GIFT



**Carpenters Union Hall
1050 Mattox Road
Hayward, CA 94541
Phone # 582 7730 / 876-8696**

x

De La Salle High plays bingo every Tuesday night in Concord. Don Henley checks out the Bugle before playing bingo.

Jerry Perez, Kathy Taylor and Chuck Taylor volunteer at the Saturday night St. Peter Martyr game in Pittsburg. See their ad for 4th of July celebration.

New Game Format

Life Chiropractic College - West

2005 Via Barrett • San Lorenzo

TUESDAY & THURSDAY
DOORS OPEN AT 5:00 P.M.
WARM UPS AT 6:30 P.M.
GAMES START AT 7:00 P.M.

SUNDAY
DOORS OPEN AT 12 NOON
WARM UPS AT 1:30 P.M.
GAMES START AT 2:00 P.M.

4 Warm Ups $75
15 Reg. Games $250
2 Specials $250
1 Bonanza $200 - 1st Winner $50 Consolation

Big End of Month Drawing All Nights

Pull Tabs • Snack Bar • Door Prizes

New Game

EDEN FIREMENS ASSOCIATION BINGO

— Monday Nights —

CARPENTERS HALL - 1050 MATTOX RD., HAYWARD

Doors Open 4:00 p.m. — Warm Ups 6:30 p.m. — Regular Games 7:00 p.m.

18 Regular Games Pay $250.00
Bonanza $250.00

3 Warm Ups $150.00 Guaranteed
5 Speed Game $50.00 Each Game
Good Neighbors With Speed Games

★ ★ ★

Pull Tabs
Door Prizes Every Night
End of Month Drawing

Snack Bar — Free Coffee
Security

THE GREAT BINGO BUGLE

X3

MON.

Cath

CORPUS CHRISTI SCHOOL
1 [illegible] Dr., Oakland/Piedmont
7:00 p.m. (See Ad) .... [illegible]

C.O.R. COMMUNITY OUTREACH
Foothill Square Bingo Hall
10700 MacArthur Blvd., Oakland/San Leandro
7:00 p.m. (See Ad) .... [illegible]

L.O.V. NEWARK BINGO
5445 Central Ave., Newark
7:00 p.m. (See Ad) .... 79[illegible]

Cath

ASSUMPTION SCHOOL
1100 Fulton Ave., San Leandro
7:00 p.m. (See Ad) .... [illegible]

CACHE CREEK BINGO
Brooks, CA
5:00 p.m. (See Ad)

CLAYTON VALLEY ATHLETIC ASSOC.
Elks Lodge
3994 Willow Pass Rd.
6:30 p.m. (See Ad)

SAN RAMON CHARITY FOUNDATION
Bingo at the Hangar
1801 San Ramon Valley Blvd
6:30 p.m. (See Ad) .... [illegible]

U.W.

~~BOYS CLUB O~~F EL SOBRANTE
4660 Appian Way, El Sobrante
7:30 p.m. (See Ad)

U.Y.

BOYS & GIRLS CLUB OF MARTINEZ BINGO
1301 Alhambra Ave., Martinez
7:00 p.m. (See Ad) 228-3677

JUST SAY NO
[illegible] Fraternal Hall
1228 36th Ave. (at 12th St.) Oakland
7:00 p.m. (See Ad)

IRVINGTON HIGH SCHOOL
41800 Blacow Rd., Fremont
6:30 p.m. (See Ad)

EDEN FIREMAN'S ASSOCIATION BINGO
[illegible]
1030 Mattox Rd., Hayward
6:30 p.m. (See Ad)

TUES.

GRANADA HIGH SCHOOL
400 Wall St., Livermore
6:45 p.m. (See Ad) .... 44[illegible]

FOOTHILL HIGH SCHOOL
4375 Foothill Rd., Pleasanton
7:00 p.m. (See Ad) .... [illegible]-1913

FREMONT SWIM & AQUATICS BOOSTERS
Niles Veterans Hall
37154 2nd St., Fremont
6:30 p.m. (See Ad)

SALESIAN HIGH SCHOOL
2851 Salesian Ave., Richmond
7:00 p.m. (See Ad)

EASTER SEALS SOCIETY
[illegible]
1050 Mattox Rd., Hayward
7:00 p.m. (See Ad) .... [illegible]-2862

LIFE CHIROPRACTIC COLLEGE WEST
2005 Via Barrett, San Lorenzo
6:30 p.m. (See Ad) .... 276-[illegible]

CACHE CREEK BINGO
Brooks, CA
5:00 p.m. (See Ad)

DE LA SALLE HIGH SCHOOL
Treat Blvd. & Winton, Concord
7:00 p.m. (See Ad) .... [illegible]-3311

ST. ANNE'S CHURCH BINGO
32223 Cabello, Union City
6:30 p.m. (See Ad)

U.Y.!

BAY AREA COMMUNITY RESOURCES
[illegible]
1228 36th Ave. (at 12th St.) Oakland
7:00 p.m. (See Ad)

U.W

[illegible] BOYS & GIRLS CLUB CHABOT BOOSTER CLUB
24400 Soto Rd., Hayward
6:45 p.m. (See Ad) .... [illegible]-5611

OAKLAND COMMUNITY OUTREACH
Foothill Square Shopping Center
10700 MacArthur Blvd., Oakland/San Leandro
6:40 p.m. (See Ad)

WED.

Cath

ST. LEANDERS CHURCH
[illegible] W. Estudillo, San Leandro
7:00 p.m. (See Ad) .... [illegible]

YGNACIO VALLEY HIGH SCHOOL
755 Oak Grove Rd., Concord
7:00 p.m. (See Ad)

Cath

PITTSBURG YOUTH PROGRAMS L.A.C. & J.F.L.
St. Peter Martyr Bingo Hall
2201 Harbor St., Suites 3 & H, Pittsburg
7:00 p.m. (See Ad) .... Starting [illegible]

UNITED CEREBRAL PALSY OF THE NORTH BAY
GAA Sports Center
90 Larwin Plaza, Vallejo
7:00 p.m. (See Ad)

bh!

JUST SAY NO
[illegible]
1228 36th Ave. (at 12th St.) Oakland
7:00 p.m. (See Ad)

CACHE CREEK BINGO
Brooks, CA
5:00 p.m. (See Ad)

AMADOR VALLEY HIGH SCHOOL
1155 Santa Rita Rd., Pleasanton
7:00 p.m. (See Ad)

BLUE DEVILS
2385 K Monument Blvd., Concord
6:30 p.m. (See Ad) .... [illegible]

BLUE ANGELS BINGO
Carpenters Union Hall
1050 Mattox Rd., Hayward
6:45 p.m. (See Ad)

CITIZENS NEIGHBORHOOD ASSISTANCE PROGRAM
Foothill Square Bingo Hall
10700 MacArthur Blvd., Oakland/S.L.
7:00 p.m. (See Ad) .... [illegible]-5662

THU

DUBLIN HIGH SCH
8151 Village Parkway, D
6:00 p.m. (See Ad)

LIFE CHIROPRACT
2005 Via Barrett, San Lo
6:30 p.m. (See Ad)

BLUE DEVILS
2385 K Monument Blvd
6:30 p.m. (See Ad)

CACHE CREEK BI
Brooks, CA
5:00 p.m. (See Ad)

LIVERMORE ELKS
940 Larkspur Dr., Liver
7:00 p.m. (See Ad)

[illegible]
1228 36th Ave., Oaklan
7:00 p.m. (See Ad)

BOYS CLUB OF E
4660 Appian Way, El S
7:30 p.m. (See Ad)

CITIZENS NEIGH
ASSISTANCE PR
Foothill Square Shopp
10700 MacArthur Blvd
7:00 p.m. (See Ad)

KABATIN BINGO
Clear Lake
6:00 p.m. (See A

CHICKEN RANC
Jamestown off Hw
7:00 p.m.

Without Advertising a terrible thing happens... Nothing.

24-Hour Hotline: 415 U-ATT

/ Advertising Information (415)

APPLIANCES • COLOR TELEVISION • STEREO
MICROWAVE OVENS • VIDEO RECORDERS

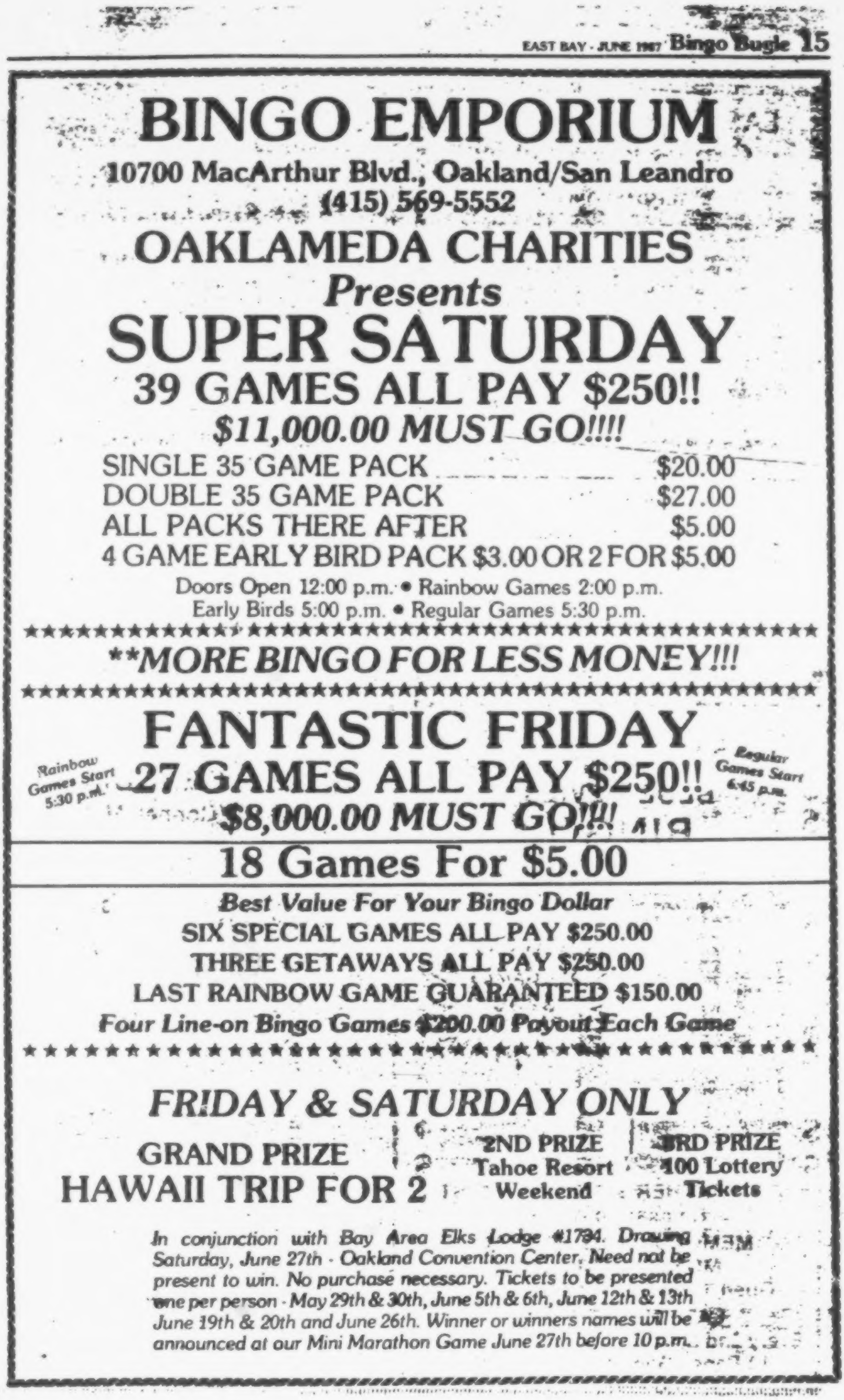
Western Appliance

TELEVISION | HOME & CAR
VIDEO RECORDERS | STEREO

BANK CARDS WELCOME

WESTERN IN OAKLAND HAS IT ALL!!
LOW PRICES • BIG SELECTION • NAME BRANDS
RCA • ZENITH • WHIRLPOOL • KITCHENAID • MAYTAG • JVC
SHARP • FISHER • PIONEER • PANASONIC • HITACHI
G.E. • FRIGIDAIRE • SONY • AMANA • GIBSON • MGA

48 HEGENBERGER CT. (Just off Hwy 17) 415-633-0655



EAST BAY · JUNE 1987 Bingo Bugle 15

BINGO EMPORIUM

10700 MacArthur Blvd., Oakland/San Leandro
(415) 569-5552

OAKLAMEDA CHARITIES

Presents

SUPER SATURDAY

39 GAMES ALL PAY $250!!

$11,000.00 MUST GO!!!!

SINGLE 35 GAME PACK	$20.00
DOUBLE 35 GAME PACK	$27.00
ALL PACKS THERE AFTER	$5.00
4 GAME EARLY BIRD PACK $3.00 OR 2 FOR	$5.00

Doors Open 12:00 p.m. • Rainbow Games 2:00 p.m.
Early Birds 5:00 p.m. • Regular Games 5:30 p.m.

****

*****MORE BINGO FOR LESS MONEY!!!***

****

FANTASTIC FRIDAY

Rainbow Games Start 5:30 p.m.

27 GAMES ALL PAY $250!!

Regular Games Start 6:45 p.m.

$8,000.00 MUST GO!!!

18 Games For $5.00

Best Value For Your Bingo Dollar

SIX SPECIAL GAMES ALL PAY $250.00

THREE GETAWAYS ALL PAY $250.00

LAST RAINBOW GAME GUARANTEED $150.00

Four Line-on Bingo Games $200.00 Payout Each Game

****

FRIDAY & SATURDAY ONLY

GRAND PRIZE	2ND PRIZE	3RD PRIZE
HAWAII TRIP FOR 2	Tahoe Resort Weekend	100 Lottery Tickets

In conjunction with Bay Area Elks Lodge #1794. Drawing Saturday, June 27th - Oakland Convention Center. Need not be present to win. No purchase necessary. Tickets to be presented one per person - May 29th & 30th, June 5th & 6th, June 12th & 13th June 19th & 20th and June 26th. Winner or winners names will be announced at our Mini Marathon Game June 27th before 10 p.m.

x5

FOOTHILL SQUARE

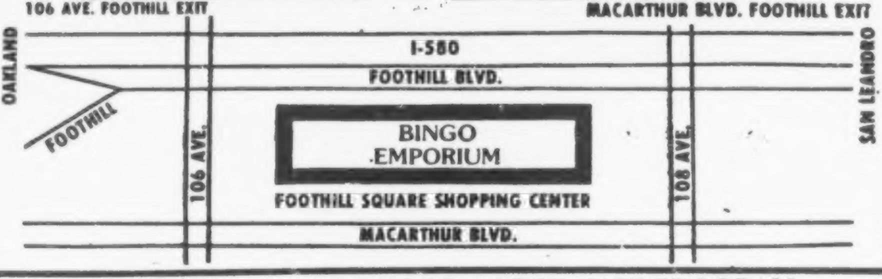
10700 MacArthur Blvd., Oakland/San Leandro
(415) 569-5552

6:40 p.m. 1:30 p.m.
Every Tuesday and Sunday
Oakland Community Outreach

Every Friday & Saturday
Oaklameda Charities Inc.
Rainbow Games 5:30 p.m. — 50/50 Split

Every Sunday & Monday
C.O.R. Community Outreach
Rainbow Games 5:30 p.m. — 50/50 Split

Every Wednesday & Thursday
Citizens Neighborhood Assistance Program
Rainbow Games 5:30 p.m. — 50/50 Split


106 AVE. FOOTHILL EXIT
MACARTHUR BLVD. FOOTHILL EXIT
OAKLAND
I-580
FOOTHILL BLVD.
FOOTHILL
106 AVE.
BINGO EMPORIUM
108 AVE.
SAN LEANDRO
FOOTHILL SQUARE SHOPPING CENTER
MACARTHUR BLVD.

CITIZENS NEIGHBORHOOD ASSISTANCE PROGRAM
Presents

WONDERFUL WEDNESDAY
and
THRILLING THURSDAY

27 GAMES ALL PAY $250!!!

$8,000.00 MUST GO!!!!!

18 GAMES FOR $5.00

BEST VALUE FOR YOUR BINGO DOLLAR
SIX SPECIAL GAMES ALL PAY $250.00
THREE GETAWAYS ALL PAY $250.00
LAST RAINBOW GAME GUARANTEED
$150.00
FOUR LINE-ON BINGO GAMES $200.00
PAYOUT EACH GAME

Doors Open 3:30 p.m.
Rainbow Games
5:00 p.m.
Regular Games
7:00 p.m.

* * *

MORE BINGO FOR LESS MONEY$$$

* * *

WEDNESDAY NIGHT ONLY
HALF TIME DRAWING COUPON
$$$$$$$$ $50.00 VALUE $$$$$$$$
NAME: ______________________
ADDRESS: ______________ CITY: ________
PH: ______________ ZIP: ________
Cut This Coupon Must Be Present To Win Cut This Coupon

THURSDAY NIGHT ONLY
HALF TIME DRAWING COUPON
$$$$$$$$ $50.00 VALUE $$$$$$$$
NAME: ______________________
ADDRESS: ______________ CITY: ________
PH: ______________ ZIP: ________
Cut This Coupon Must Be Present To Win Cut This Coupon

EASTER SEALS BINGO
Games Pay $250.00

TUESDAYS ONLY

Carpenter's Union Hall
1050 Mattox Rd., Hayward
Doors Open 4:45 p.m.
Game Time 7 p.m.
2 Regular Packs $10.00

Wheel of Fortune
and E.O.M. Drawing
Trip for 2 to Reno
Overniter Deluxe
Plus $100.00 Cash
LILY SPACE PAYS
MINIMUM $500.00

FRIDAYS ONLY

Local 6 Warehouse Union Hall
99 Hegenberger Rd., Oakland
Doors Open 4:45 p.m.
Game Time 7 p.m.
Plus 1st & 3rd Sun.
2 Regular Packs $10.00

June 12th & 26th
6 Free Games
Total Payout
$950.00
638-5606

SUNDAYS ONLY

Local 6 Warehouse Union Hall
99 Hegenberger Rd., Oakland
Doors Open 11 a.m.
Game Starts 1 p.m.
3 Regular Packs $10.00

June 7th & 21st
4 Free Games
Total Payout
$800.00
638-5606

CASH DOOR PRIZES EACH SESSION
PLUS DRAWINGS
Bonanza 50/50 Split • Pull Tabs • Snack Bar
For Information Call (415) 635-3987

Higher Pots
TEMPLE ISRAEL BINGO
ALAMEDA
Sundays

10 Regular Game Paper Pack
$5.00
Increase Game Payouts
$150.00

Doors Open 5 p.m. - Early Bird 6:30 p.m.
Regular Games 7 p.m.
PULL TABS - SPECIALS - GETAWAYS - BONANZA
SNACK BAR - SECURITY - LIGHTED FREE PARKING

Guaranteed Blackout $250.00
SPECIAL DOOR PRIZES
Join us on Sunday Evening and Bring a Friend!

3183 Mecartney Rd. Near Island Drive
Harbor Bay Landing Shopping Center - Bay Farm Island

$$$$$$$$$$$$$$$$$$$

BLUE DEVILS
BINGO

Non-profit organization for the Blue Devils Marching Units
2395 "K" Monument Blvd., Concord, Ca.
(Corner of Cowell and Monument)
689-4696

Your Choice:
Paper or
Hard Cards

ALL GAMES
$250
PAYOUT

10 Players Spin New Wheel of Fortune Each Session

WED. THURS. FRI. SAT. NIGHTS
OPEN 5 P.M. • EARLYBIRDS 6:30
Regular Games 7:30

SUNDAY AFTERNOON
OPEN 11:30 am • EARLYBIRDS 1:30 pm
Regular Games 2:30 pm

OPEN FATHER'S DAY JUNE 21ST
Regular Schedule
MEMORIAL DAY SPECIAL
MONDAY, MAY 25th
Open 1:30 p.m. — Game 3 p.m.
LATE NIGHT BINGO
Every 2nd & 4th Friday Night 11:15 pm
10 Paper Games — 75/25 Split

HIGHER POTS ON WEDNESDAY

ST. LEANDERS BINGO

Ryan O'Connell Hall
San Leandro
895-5631

Every Wednesday

Doors Open 6 p.m.
Games at 7 p.m.
All Paper Games
Reg. Games $250
Blackout $250
3 Early Birds
3 Getaways
Bonanza
Door Prizes
Pull Tabs

Saturday
June 6
June 20

Doors Open 4 p.m.
Games at 5:30 p.m.
All Paper Games
Double Pack $[illegible], Single Pack $13
(Includes all games)
All Games $250
3 Early Birds, 3 Getaways
Bonanza, Door Prizes
Pull Tabs
Extra Door Prize

★ Saturday EXTRA Surprise Door Prize

• Free Coffee • Snack Bar
• Lots of Parking
• Fenced in Parking Lot
• 2 Uniformed Security Guards
On-Duty in Hall and Parking Lot

Ryan O'Connell Hall
San Leandro Blvd. & Estudillo
San Leandro

X7

CACHE CREEK BINGO

For Further Information:
1-800-452-8181
For Recorded Jackpot Information:
1-800-992-8686

HWY 16 — 12 Miles West Of
Interstate 505 To
BROOKS, CA PO BOX 65, 95606

DOUBLE HEADER

SUNDAY, JUNE 21st

OVER $60,000 IN CASH & PRIZES

1ST SESSION —
ALL REGULAR GAMES PAY $1,000 EA.
ALL PACKS $20 EACH
DOORS OPEN AT 10:00 A.M.

- ★ 2ND NIGHT OWL SESSION
- ★ ALL REGULAR GAMES PAY $2,000 EA.
- ★ 1ST PACK $30 —
  EACH ADDITIONAL $15

SATURDAY JUNE 6TH
"MINI MARATHON"
ALL REGULAR GAMES $1,000 EA.
ALL SPECIALS PAY $4,000 EA.
ADMISSION $30 FIRST PACK
2ND PACK $25
3RD & EACH ADDITIONAL $20
DOORS OPEN AT 10:00 A.M.

$ $ SUNDAY JUNE 14TH $ $
$ "MINI MONEY MANIA" $
OVER $75,000 IN CASH & PRIZES
ALL REGULAR GAMES PAY $2,000 EACH
1ST PACK $50 • 2ND PACK $30 • 3RD PACK $20
4TH & EACH ADDITIONAL $10
DOORS OPEN AT 10:00 A.M.

SUNDAY	MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY	SATURDAY
MONDAY THRU FRIDAY: Doors Open 5:30 P.M. SATURDAYS & SUNDAYS: Doors Open 11:30 A.M.	1 BARGAIN NIGHT 1ST PACK $15 ADDITIONAL $10 EA.	2 KING OR QUEEN DRAWINGS	3 GOOD NEIGHBOR NITE REGULAR SESSION	4 ALL YOU CAN PLAY DRAWINGS REGULAR SESSION	5 REGULAR SESSION	6 "MINI MARATHON" ADMISSION PACK $30 2ND PACK $25 EA. ADDITIONAL $20 DOORS OPEN 10:00 A.M.
7 REGULAR GAMES $1,800 1ST PACK $30 ADDITIONAL $20 EA $10,000 BLACKOUT MUST GO	8 "[illegible] 8 [illegible]" BINGO ON ANY NUMBER ENDING IN 8 — $850 BONUS BINGO ON NUMBER 8 — $780 BONUS	9 KING OR QUEEN DRAWINGS	10 BARGAIN NIGHT 1ST PACK $15 ADDITIONAL $10 EA	11 ALL YOU CAN PLAY DRAWINGS REGULAR SESSION	12 REGULAR SESSION	13 SUPER SATURDAY REGULAR GAMES PAY $1,800 2 PACKS $35 1ST PACK $25 ADDITIONAL $10 EA.
14 "MINI MONEY MANIA" 1ST PACK $50 2ND PACK $30 3RD PACK $20 4TH & ADDITIONAL $10	15 REGULAR SESSION	16 KING OR QUEEN DRAWINGS	17 REGULAR SESSION	18 ALL YOU CAN PLAY DRAWINGS REGULAR SESSION	19 BONUS NIGHT REGULAR GAMES $780 1ST PACK $20 ADDITIONAL $10 EA.	20 SUPER SATURDAY REGULAR GAMES PAY $1,800 2 PACKS $35 1ST PACK $25 ADDITIONAL $10 EA.
21 "DOUBLE HEADER SESSION" 1ST SESSION — REG GAMES $1,000 EA NIGHT OWL SESSION— REG GAMES $2,000 EA	22 GOOD NEIGHBOR NITE REGULAR SESSION	23 KING OR QUEEN DRAWINGS	24 "WEDNESDAY SHOPPER" ALL REGULAR GAMES $[illegible] EA. ALL PACKS $[illegible] EA.	25 ALL YOU CAN PLAY DRAWINGS REGULAR SESSION	26 "2 FOR 1 SPECIAL" 2 PACKS FOR $[illegible] ADDITIONAL $10 EA.	27 [illegible] ANNIVERSARY CARNIVAL [illegible] ADVANCE TICKETS DOORS OPEN 9:30 A.M.
28 WINNERS CIRCLE "NEW CAR" 2 PACKS $50 ADDITIONAL $20 EA *$10,000 BLACKOUT*	29 REGULAR SESSION	30 KING OR QUEEN DRAWINGS	**JUNE 1987** *EVERY DAY — THREE DRAWINGS TO SPIN OUR FABULOUS "WHEEL OF FORTUNE"*			

BUS TRANSPORTATION AVAILABLE

ANTIOCH-PITTSBURG-CONCORD
GERT (415) 439-[illegible] MURDIS (415) [illegible]
CECILE RUSHDAN (414) 432-[illegible]
RICHMOND-SAN PABLO-BERKELEY—ALBANY
ESSIE (415) 2[illegible]
OAKLAND-SAN LEANDRO
ATLEE WILLIAMS (415) [illegible]
NANCY (415) 482-5616
CHARLOTTE (415) 632-0440
ALAMEDA
NANCY (415) [illegible]
VALLEJO
VERGIE (707) 429-[illegible] MIKE (707) [illegible]
FAIRFIELD-VACAVILLE
VERGIE (707) 429-9234

STOCKTON-LODI
LOLLIE (209) [illegible]
OROVILLE-YUBA CITY-PARADISE
SHARON (916) [illegible]
CHICO-PARADISE
JOANNE (916) 345-4163
SAN MATEO-SAN BRUNO-SAN FRANCISCO
LULA (415) 574-2706 LIZ (415) [illegible]
REDWOOD CITY — HANK (415) [illegible]
PACIFICA-DALY CITY-SAN FRANCISCO
MARIA (415) [illegible]
SAN BRUNO-SAN FRANCISCO
EULA (415) 822-6067
HAYWARD-UNION CITY
MARY JOHN (415) [illegible]

SANTA CLARA-CUPERTINO-MILPITAS-
SAN JOSE-FREMONT
MARLENE (408) [illegible]
LOIS (408) [illegible] DEANA (408) [illegible]
MT. VIEW-SUNNYVALE-SANTA CLARA
[illegible] (408) [illegible]
PALO ALTO
[illegible]
SACRAMENTO-RANCHO-WOODLAND-ROCKLIN
DOTTY (916) [illegible] PAT (916) [illegible]
SACRAMENTO
[illegible] (916) [illegible] HARVEY (916) [illegible]
AUBURN-GRASS VALLEY
SMITTY & DOTTY (916) [illegible]
SALINAS-SOLEDAD-SEASIDE
SUE PORTUGALIZA (408) 757-[illegible]

WINDSOR-SANTA ROSA-PETALUMA
SAN RAFAEL-NOVATO
BETTY (415) [illegible] BETSY (707) [illegible]
SONOMA-NAPA
[illegible]
[illegible] PARK
[illegible]
LAKEPORT-[illegible]-CLEAR LAKE
BETTY [illegible]
FT. BRAGG-WILLITS-[illegible]
[illegible]
ST. HELENA —[illegible]
[illegible]-RED BLUFF-[illegible]-WILLOWS
[illegible]

x8

FREMONT SWIM & AQUATIC BOOSTERS

Invites You To Our

Tuesday Night Bingo Game

4:30 Doors Open • 6:30 Early Birds
7:00 Regular Games, Specials

Early Birds Pay $100.00
Regular Games & Specials Pay $250.00

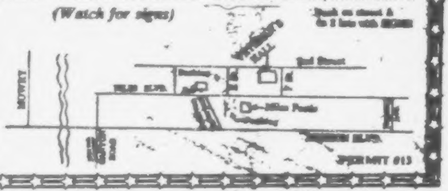
2nd Tuesday - Triple Pack for Price of Double
3rd Tuesday - $5.00 Off

End of Month Drawing $250.00

Table Drawing - Wheel of Fortune - Let's Make A Deal

Free Coffee • Smoking & Non-Smoking Halls • Pull Tabs
Friendly Workers • Uniformed Security Guards

NILES VETERAN'S HALL - 37154 2ND ST., FREMONT
(Watch for signs)



Western Entertainment Syndication Company presents

ONE MILLION DOLLAR 8-WEEK BINGO TOURNAMENT

August 16 through October 4
$50,000 Guaranteed Payouts Each Week

GRAND PRIZE PLAYOFF

for One Million Dollars ($50,000 a year for 20 years)
is October 17.

This Northern California bingo tournament will take place at a fabulous MAJOR casino in Lake Tahoe.

$250 BUY-IN Includes:

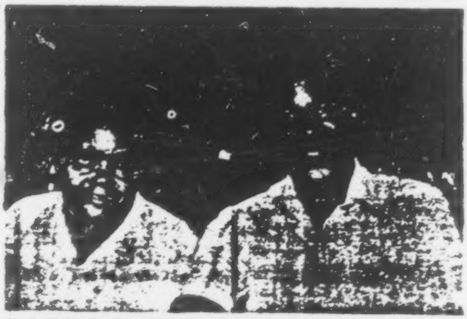
- Bus trip for you and guest to Lake Tahoe
- Casino gift package for 2
- Buffet for 2
- One entry into Bingo Tournament

Call: (209) 276-8186, (209) 229-5340 or (805) 498-0764

DO NOT SEND MONEY!
This form is only to express your interest and to get more information.
Limited Seating. Reservations 1st received 1st served.

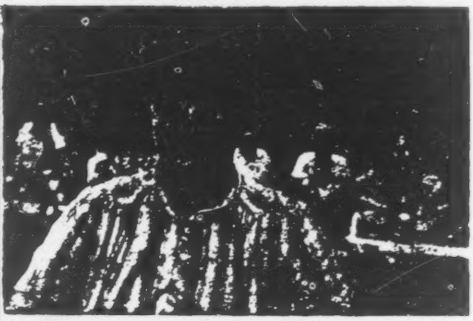
Name: ____________________
Address: ____________________
____
Phone: ____________ Date wish to play: ________
# reservations desired: ________
Check here for information on how non-profit organizations can participate: ________

Mail to:
WESCO
P. O. Box 11246
Fresno, CA 93772



Boy's Club in Richmond plays every Saturday afternoon. Alice and Clarence Seguini Jr. play this game each week.

Congratulations [illegible]! Vicki received [illegible] and a plant from Sherman Paff, Chairman of the Richmond Boy's Club, for her outstanding work and commitment to the club. They play bingo on Saturday afternoons.



Rose Breice says she plays 6 nights of bingo and of course Mondays she's at Irvington Hall.

Tom Green and Gary Vivo (Bingo Chairman) posed at their Monday night game at Carpenters Hall, in Hayward. The game is sponsored by the Eden Firemen's Association.

YOU AND YOUR HEALTH

For Mrs. P.: Your mother's heart condition should be carefully monitored, especially if she has been taking digitalis. Too much of it can produce toxic symptoms. Her persistent nausea should alert you to the possibility she has been taking too much for too long. Other symptoms of digitalis toxicity are loss of appetite, abdominal pain, excessive tiredness, headaches and trouble with her vision. I suggest you check with her doctor.

• • •

Dear Dr. Ease: I'm [illegible] for dieting, but now I have a slight rise in my blood pressure and am at least 25 pounds overweight. I think I have no choice other than taking antihypertensive pills. I'd rather not start. Would losing the extra pounds and cutting down on my salt intake be effective in controlling my blood pressure? — Mrs. L.

Dear Mrs. L.: You won't be wasting time and effort. In many cases even a modest reduction of weight loss and salt has brought pressure down to normal.

• • •

For Mrs. O.: If you're concerned about possible broken bones in your son when playing on his high school football team, consider further medical screening. Although physicians usually examine young athletes, you may feel better if you have your own physician give him a physical examination which includes electrocardiograms and other tests. Apparently normal hearts in a routine examination may still show abnormalities in a complete examination.

• • •

For Mrs. J.: Diarrhea itself is not usually the outstanding symptom of diverticulitis. Pain is usually present. My only suggestion is to have x-ray examinations of your lower bowel. If everything seems to be all right, look into the possibility of food or even lactose intolerance.

KEEPING FIT

There is much controversy about pregnancy and exercise. If a woman is involved in a regular exercise program before becoming pregnant, there is no reason to expect her to completely give up her lifestyle afterwards. However, strenuous exercise requires caution and special consideration.

It has been proven that being in good physical condition has its advantages for childbearing. Exercise during pregnancy helps to control weight gain, decrease backache, decrease "postpartum belly," decrease varicose veins and constipation, improve sleep, increase energy levels, and to cope with the physical stress of labor and delivery.

While there is no question about the mother's benefits, the controversy is over the effects on the fetus. The baby is protected inside the mother during pregnancy, so jumping around will not hurt it during the first two trimesters. But doctors still don't know how increased heart rate and blood volume and decreased oxygen levels affect the baby.

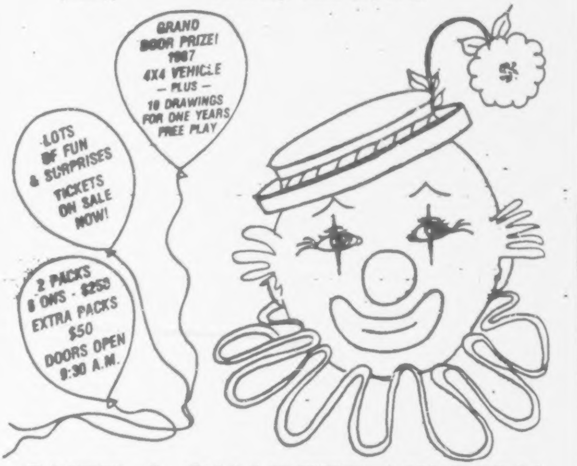
All women should check with their doctors before beginning or continuing an exercise program during pregnancy.

© 1987, McNaught Synd.

MONDAY NIGHTS
Corpus Christi School
Park Blvd. at Estates Dr.
Oakland/Piedmont
(415) 530-4056
— EVERY MONDAY —
7:00 p.m. - Doors Open 5:30 p.m.
ALL REGULAR GAMES
pay $250.00
Wheel of Fortune with
EXTRA Prizes
SECURITY & FREE LIGHTED PARKING - WHEEL CHAIR ACCESS

BINGO SUPPLY MANUFACTURERS
OVERNIGHT SERVICE ON:
★Custom Color Collated Packs
Cut & Finished in our N. California Facility
(3-On/4-On/6-On/9-On/12-On)
★Bingo Seminars
Complete in-service presentations for your new or existing game
★Largest Selection of Breakopens
in Northern California
★Complete Line of Bingo Equipment
★Bingo Supplies & Accessories
WEST COAST BINGO CORPORATION
San Jose Office: (408) 996-7796 Main Office & Mfg.: 1-800-874-9369

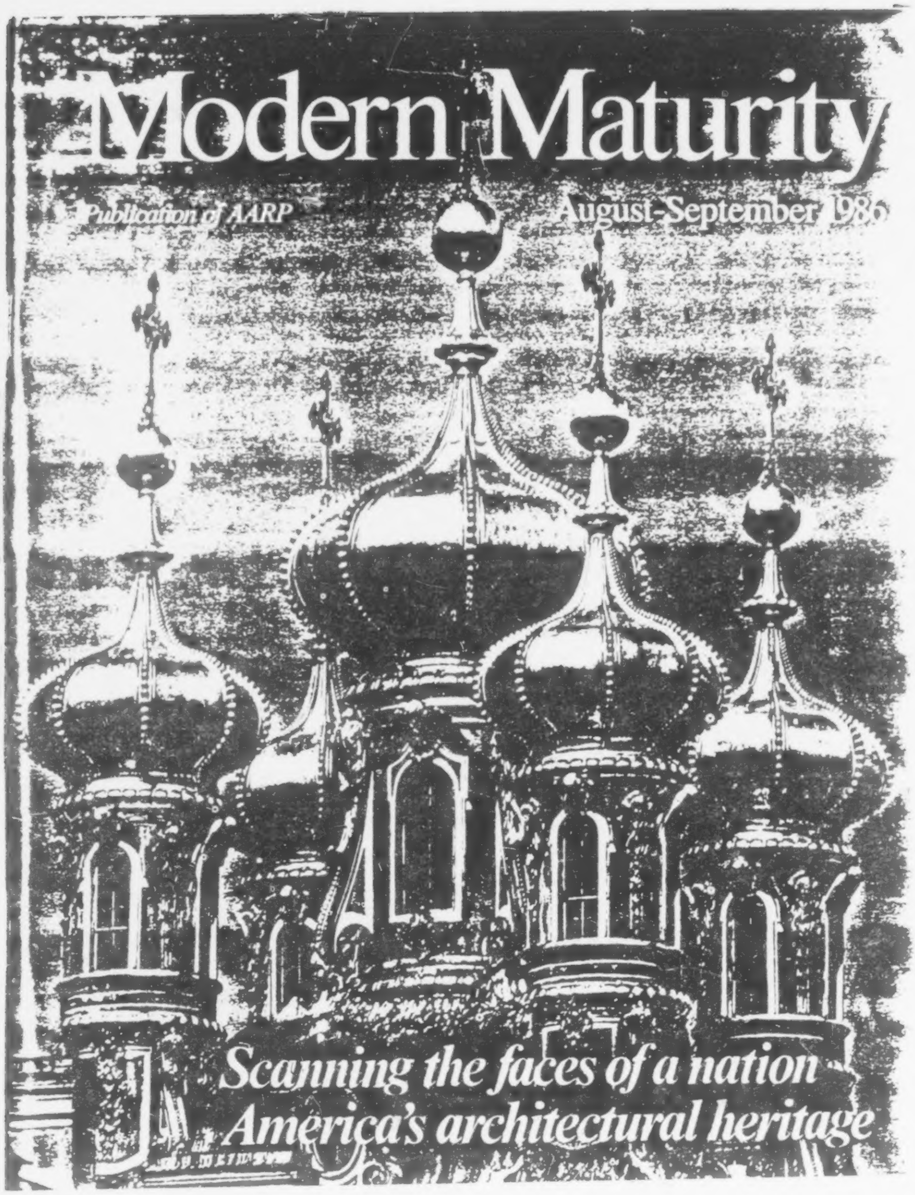
CACHE CREEK BINGO
2nd Anniversary Carnival
Saturday, June 27, 1987


GRAND DOOR PRIZE! 1987 4X4 VEHICLE — PLUS — 10 DRAWINGS FOR ONE YEARS FREE PLAY
LOTS OF FUN & SURPRISES TICKETS ON SALE NOW!
2 PACKS 6 ONS - $250 EXTRA PACKS $50 DOORS OPEN 9:30 A.M.

OVER A QUARTER MILLION IN CASH AND PRIZES!

ADVANCE TICKET HOLDERS RECEIVE 2 CHANCES FOR ALL DRAWINGS!
2nd Anniversary Celebration — Saturday, June 27, 1987
Reservations Recommended!!
• ADVANCED TICKETS ON SALE AT MAIN OFFICE
• USE MASTERCARD OR VISA BY PHONE OR MAIL
• SEND MONEY ORDERS ONLY BY MAIL
• CASHIER APPROVED CHECKS ONLY
• DO NOT SEND CASH BY MAIL
Name ____
Address ____
City ____ State ____ Zip ____
Phone ____
Signature ____
Quantity ____ Tickets at [illegible] each
Money Order Enclosed For $ ____
OR
[illegible]
My Visa Number is ____
My MasterCard Number is ____
(Subject to Credit Approval)
My Card Expires Mo. ____ Yr. ____
Sign. [illegible] ____
[illegible]
ALL TICKETS MUST BE PICKED UP BY FRIDAY, JUNE 26, 1987
DOORS OPEN 9:30 A.M. FOR ALL ADVANCED TICKET HOLDERS
MAIL ORDER TO: CACHE CREEK BINGO
P.O. BOX [illegible]
BROOKS, CA [illegible]
or CALL 1-800-452-[illegible] for Visa or MC Orders
FOR RECORDED INFORMATION CALL 1-800-[illegible]

WARM UP GAMES......$4,000
EARLY BIRD............$20,000
12 REG. GAMES...$10,000 EA.
MID SPECIAL...........$20,000
JACK POT...............$40,000
10 GET-A-WAY GAMES................$1,000 EA.
GET-A-WAY JACKPOT..$5,000



Modern Maturity

Publication of AARP

August-September 1986

Scanning the faces of a nation

America's architectural heritage

Modern Maturity

Volume 29 Number 4
August–September 1986

20 **Doctor in the house** Meet new Health and Human Services Secretary Otis Bowen, a team player and problem solver.

28 **The faces of Russia** First-time visitor comes away with mixture of impressions about people and places he sees.

40 **Taking command of arthritis** Learn about the myths, gain knowledge about positive approaches—and feel better.

Cover: Glittering onion domes of Catherine's Palace, Pushkin, Leningrad (See page 28).
IAN YEOMANS/WOODFIN CAMP & ASSOCIATES

Inside cover: The Cascades in Tettegouche State Park on the north shore of Lake Superior, Minnesota (See page 48).
GREG RYAN/POSITIVE REFLECTIONS

Back cover: First snowfall at Tettegouche State Park, Minnesota (See page 48).
GREG RYAN/POSITIVE REFLECTIONS

46 **How fit are you?** Extend your life expectancy and improve your health by breaking old habits and beginning new ones.

48 **North-star outpost** Wander along jagged cliffs above rushing water and experience Minnesota's magic.

54 **Monumental America** Behind-the-scenes look at how some of our nation's most inspiring symbols were built.

64 **Kool kids** There's no better taste treat on a sweltering summer day than ice cream.

68 **Commitment on canvas** Painter Jacob Lawrence fuses an expressionistic style with a moving humanitarian message.

79 **Your money and the news** What you read about in the financial pages can have an effect on your pocketbook.

90 **Passport to adventure** A yen for the exotic or unusual is satisfied by adventure tours that range from easy to awesome.

Departments

3 Readers write
10 Spotlight
13 Upfront
16 Our opinion
18 Consumer alert
26 Laughing matter
38 Fun fare
63 Staying well
77 Puzzle
82 What should I do?
83 AARP closeup
84 Capital outlook
86 Chapters in action
88 At your service
100 Verse

Buick Somerset

Special low AARP rates: Just one reason to rent a National Car.

Here are more good reasons…

✓ **National's Cars were named "best in overall condition."** According to a nationally projectable study of the major car rental companies conducted by the United States Auto Club.

✓ **Emergency road service** is available 24 hours every day. You'll probably never need it because of our well-maintained cars. But it's nice to know that one toll-free phone call will bring you assistance from National or the Amoco Motor Club, coast to coast.

Amoco Motor Club

✓ **Special low rates** are available worldwide. Special low AARP daily rates apply, as well as discounts on our already low weekend, weekly, and holiday rental rates. Similar values are yours through National and our affiliates around the world.

✓ **Call toll-free for reservations.** Just dial 800-CAR-RENT℠ for reservations and information. Choose your car from our wide selection of stylish, well-equipped vehicles in any size you need. Give us a call, or contact your travel consultant, and get National attention®

National Car Rental.

In Europe, Africa and the Middle East it's Europcar. In Canada it's Tilden.

SKIP-BO
Another Family Card Game from the makers of
UNO
Number One in Fun

NOT FOR THE RETIRING TYPE.

Nothing goes with good times and good company like a great card game: SKIP-BO® It combines skill, strategy and luck for hours of fun. And when you team up, it's twice as exciting.

From the makers of UNO® America's family get together™

© 1984 International Games, Inc.

AARP AMERICAN ASSOCIATION OF RETIRED PERSONS
Dr. Ethel Percy Andrus, Founder

ADMINISTRATIVE OFFICES
NATIONAL HEADQUARTERS
1909 K St NW
Washington, DC 20049

WESTERN OFFICE
3200 E Carson St, Lakewood, CA 90712

MEMBERSHIP PROCESSING CENTER
3200 E Carson St, Lakewood, CA 90712

PHARMACY SERVICE
1909 K St NW (walk-in service only)
Washington, DC 20049

6500 34th St N, PO Box 14417
St. Petersburg, FL 33733
For members in: FL, MS, AL, GA, SC, NC, TN

3200 E Carson St (walk-in service only)
Lakewood, CA 90712

3823 Broadway, PO Box 1444
Kansas City, MO 64111
For members in: MO, KS, NE, SD, ND, MN, WI, IA

701 Main St, East Hartford, CT 06167
For members in: CT, RI, MA, VT, NH, ME
& Eastern NY (zips 10000-12999)

3557 Lafayette Rd
PO Box 7010, Indianapolis, IN 46222
For members in: IN, MI, IL, OH, KY, WV, VA

9800 SW Nimbus Ave, Beaverton
PO Box 2755, Portland, OR 97208
For members in: OR, WA, AK, HI, ID, MT, WY, CO & Northern CA (zips 94000-96139)

450 York Rd, PO Box C5020
Warminster, PA 18974
For members in: PA, MD, DE, DC, NJ
& Western NY (zips 13000 & up)

5947 Boulder Hwy, PO Box 18422
Las Vegas, NV 89114
For members in: NV, AZ, UT &
southern CA [illegible]

5050 E Belknap, PO Box [illegible]
Fort Worth, TX 76117
For members in: TX, LA, AR, OK, NM

GROUP HEALTH INSURANCE
Health Claims Unit
PO Box 13999, Philadelphia, PA 19187-0216

AARP FOUNDATION
3200 E Carson St, Lakewood, CA 90712

AARP ANDRUS FOUNDATION
1909 K St, NW, Washington, DC 20049

If you have questions or complaints about advertisers in MODERN MATURITY, *please direct them to:*

Advertising Standards Department
Modern Maturity, 3200 E Carson St
Lakewood, CA 90712

MODERN MATURITY (ISSN 0026-7346, Permit #357-600) is published bimonthly by the American Association of Retired Persons, 3200 E Carson St, Lakewood, CA 90712. Annual membership dues are $5, including $2.40 for an annual subscription to MODERN MATURITY and 60 cents for an annual subscription to the AARP NEWS BULLETIN ($7 per year outside domestic U.S. mail limits). A three-year membership is $12.50; a 10-year membership is $35. Second-class postage paid at Lakewood, CA, and at additional mailing offices. POSTMASTER: Send address changes to American Association of Retired Persons, 3200 E Carson St, Lakewood, CA 90712. AARP is a nonprofit, nonpartisan, social welfare, philanthropic, educational and scientific membership organization. AARP is dedicated to helping all older men and women achieve independence, dignity and purpose. AARP assumes no responsibility for unsolicited manuscripts or other materials submitted for review. Entire contents Copyright 1986 by the American Association of Retired Persons. All rights reserved under the Berne and Pan American copyright conventions. Reproduction in whole or part without written permission is prohibited. Printed by R. R. Donnelley & Sons.

You, too, may be able to save–up to $60... $70... $100 or more–with the AARP Automobile Insurance Program from The Hartford.

Want to cut your auto insurance costs? Look to the AARP Automobile Insurance Program from The Hartford! It was created especially for AARP members—and designed specifically to save you money on the coverage you need.

Low Rates Plus Special Discounts Add Up to Substantial Savings for You

The AARP Automobile Insurance Program starts with premium rates that can be lower —by 10% or more— than those charged by most other leading companies. And you'll pay *even less* with these money-saving discounts:

Safe-driver discount for maintaining a good driving record.

Driver training discount for completion of an accredited accident prevention training course like the AARP 55 Alive/Mature Driving Program.

Low mileage discount for mature drivers who travel below-average annual mileage.

Automobile/Homeowners Account discount for those insured under both the AARP Automobile and AARP Homeowners Insurance Programs.

Although specific features and discounts may vary from state to state in accordance with local law, the Program's low rates and special discounts could save you $60...$70...even $100 or more for the same coverage you have now!

You Get Extra-Special Service and Security, Too

The Hartford has made a special commitment to serving you. A network of local claims offices across the country is staffed by thousands of experienced representatives—ready to provide you with prompt, direct claims service. A 24-hour toll-free emergency claims number lets you call for help any time, from any place in the United States. Plus, there's a national Insurance Center you can call toll free for answers to your questions about rates and coverage.

Just as important, your AARP Automobile Insurance Program policy is renewable for life, once you're insured through the Program for 60 days and as long as you meet a few simple requirements. And since you'll receive a 12-month policy—not a six-month policy—your low rates will be locked in for a full year.

Compare Costs—With a Personalized Premium Quotation

It's easy to find out how much *you* could save with the AARP Automobile Insurance Program! If you qualify, and over 90% of all AARP members do, The Hartford will rush you a free Premium Quotation so you can compare our coverage and low costs to your present auto insurance.

Simply fill in and mail the attached postage-paid form. Or, if you prefer an immediate quote over the phone, you can call toll free

1-800-423-2121

Service hours are 8:30 a.m. to 8:00 p.m. Eastern Time, Monday to Friday. (To speed your quote, please complete the attached form and have it handy when you call.)

AARP AUTOMOBILE INSURANCE PROGRAM
THE HARTFORD
Hartford, CT 06155

Currently available in all states except Maine. The AARP Automobile Insurance Program is provided by The Hartford Insurance Group (Hartford Accident & Indemnity, New York Underwriters Insurance Company, in association with Alexander & Alexander (except in Wyoming).

Ask about our Senior Citizen Discount.
More than 1300 Best Westerns offer
[illegible]
1-800-528-1234
The Right Place
world's largest chain of independently [illegible]

Best Western
INDEPENDENT WORLDWIDE LODGING
Best Western
INDEPENDENT WORLDWIDE LODGING

"Gray Line is the first-class way to see a city on a budget."

"There's a difference between going somewhere and really seeing it. For 76 years, world wide Gray Line trips and tours have been giving people the in depth view. Comfortable, convenient, informative, fun, they give you that 'first class feeling' - at surprisingly modest prices. We love them."

To: Gray Line Sightseeing Association, Inc.
350 Fifth Avenue, New York, N.Y. 10118
MM 8/9
Mail this coupon now for free brochures.
Please send me your free illustrated Gray Line brochures.
I plan to visit the following cities.________________
____
____
Name________________
Address________________
____
City________________
State________________
Zip________________

Modern Maturity

Publishing Director Robert E. Wood
Editor Ian Ledgerwood
Art Director James H. Richardson
Production Director Charles W. Allen
Advertising Standards Director Treesa Drury
Managing Editor Linda Hubbard
Executive Editor Lorena Fletcher Farrell
Senior Copy Editor Idamae Blois Brooks
Washington Bureau Elliot Carlson, Chief
Food Editor Florence Gross
Senior Editors David W. Black, John Wood
Picture Editor Michaelene J. Wadolny
Travel Editor Charles N. Barnard
Associate Editors Dorothy Jewell, Annette Winter
Articles Editor Karen C. Reyes
Deputy Art Director Lloyd D. Haynes
Associate Art Directors David J. Fuller, Maggie Lowe, Marcia Forsberg
Research Librarian Shirley Ahlgren
Copy Assistant Darcie L. Furfaro
Picture Assistant Valerie L. Holmes
Library Assistant Mickey T. Mellevold
Quality Analyst Linda G. Markese
Senior Production Associate Brenda Lang Allen
Production Associate Traci L. Lucien
Production Assistant Sharon L. Deeming
Photographer Daniel S. Brown
Publishing Assistants Brenda Mann Allen, Theresa Rademacher
Advertising Standards Associate Vanessa [illegible]
Advertising Standards Assistant Tomiko Anderson
Editorial Services Alice Medina, Chief, Betty Nolta, Eileen Dawson, Joan Givens

EDITORIAL OFFICES
3200 E Carson St. Lakewood, CA 90712
213-496-2277 Telecopier 213-496-4124

Advertising Director Joseph E. (Peter) Hanson Jr.
National Sales Manager Ina S. Josephson
Advertising Services Manager Patricia Mondello
Marketing Manager Clifton Fichtner
Promotion Manager Alfred Gillespie
Sales Representatives Chuck Baldi, Thomas J. Condon, Paul Marden, Jack Sinnott
Advertising Traffic Coordinator Nancy Nazaurvitch
Billing Coordinator Catherine Callan
Advertising Assistants Virginia Mazziotti, Barbara Bogart, Francesca Comucchio, Joan Samuels

ADVERTISING OFFICES 420 Lexington Ave. New York City 10017

MPA
Member of Magazine Publishers Association

Audit Bureau of Circulations

The American Association of Retired Persons is a nonprofit, nonpartisan organization of more than 20 million members aged 50 and over. The Association was established in 1958 by Dr. Ethel Percy Andrus, the founder of NRTA, with four purposes: to enhance the quality of life for older persons, to promote independence, dignity and purpose for older persons, to lead in determining the role and place of older persons in society, and to improve the image of aging. More than 35,000 members volunteer in numerous programs and services, represent the older population's viewpoint before legislative and government bodies and organize community efforts through more than 3,400 local chapters. Our motto: To serve, not be served.

9.56%

High Yields...Plus AARP's Commitment to Quality and Service.

AARP members have already invested over $1 billion in the AARP Ginnie Mae Fund!

Now may be a good time for you to learn more about Ginnie Mae funds, one of today's highest yielding government investments. And about how you — like so many other AARP members — can take advantage of these attractively high yields through the AARP Ginnie Mae Fund. Add the AARP ADVANTAGE to these high yields and you'll see why the Fund is so popular. In fact, over 75% of members participating in the AARP Investment Program have already invested well over $1 billion in this Fund!

What makes the AARP Ginnie Mae Fund so attractive?

1. The Fund invests primarily in Ginnie Mae securities and U.S. Treasury obligations, both of which are 100% guaranteed by the U.S. Government. This guarantee doesn't apply to the yield or price of your shares which will go up and down with market conditions. For instance, on 5/14/85, the Fund's share price was $15.12. One year later it was $16.01. Of course, this example is no guarantee of future performance. The current annualized yield available at time of publication (7 days ending 5/14/86) was 9.56%. For today's yield call toll-free 1-800-631-INFO.
2. The AARP Ginnie Mae Fund is a no-load mutual fund, which means you don't pay any sales charges, so *100% of your money goes to work for you.*
3. You have access to as much or as little of your current investment as you need, *without transaction fees.*
4. As a mutual fund, the AARP Ginnie Mae Fund aims to reduce risk by diversifying your investment across a broad range of securities. This important work is handled by Scudder, Stevens & Clark, an investment management company with over 65 years of experience.

What is the AARP ADVANTAGE?

It's a combination of four special benefits you can't find in any other investment program: AARP's commitment; Scudder, Stevens & Clark's investment management experience; personal service and information from representatives working exclusively for AARP members; and access to six other funds in the AARP Investment Program, with phone call transfer privileges.

How do I find out more?

Just fill out the coupon below or call 1-800-331-1100 and ask for extension 454.

The Fund's underwriter is Scudder Fund Distributors, Inc.
175 Federal Street, Boston, MA 02110

Send for your free Information Kit today!

☐ **Yes!** I want to find out more about the AARP Ginnie Mae Fund. Please send me a free no-obligation Information Kit right away, including a prospectus containing more complete information about the Fund, the roles of Scudder and AARP, and the fees they may receive. *I will read these materials carefully before I invest or send money.*

(Please print clearly)

Name ____________________

Address ____________________

City ____________________ State ______ Zip __________

8/86

Mail to: AARP Investment Program
Processing Center
P.O. Box 34913
Omaha, NE 68134-0913

Or call toll-free: 1-800-331-1100 and ask for extension 454, 24 hours a day, 7 days a week.

AARP Investment Program
from **SCUDDER**

Lenox.

First Waltz

A Lenox tribute to
American fashion – created
under the guidance of our
country's leading costume experts.

Individually crafted of fine
handpainted porcelain.

Available only by reservation.

Shown smaller than actual height of 8¼"

© Lenox, Inc. 1986

It is 1895, the heart of what was known as the "Gibson Era" or "Gay Nineties" – At a society ball an elegant young lady awaits the man to whom she has promised the first waltz. She is dressed in the height of fashion: pearl choker, ribbed silk gigot sleeves and ostrich-feather fan. Her silk brocade skirt is designed to flow gracefully with the whirling motion of the waltz – the popular dance of the day.

First Waltz has been created by Lenox under the guidance of distinguished fashion authorities – Vera Maxwell, renowned fashion designer; Carrie Robbins, award-winning Broadway costume designer; Robert Riley, Fashion Institute of Technology and Matthew Kiernan, Costume Society of America. This lovely figurine represents one of the most important eras in American fashion and is *historically accurate down to the finest detail.*

A Handcrafted Work of Art

Conceived and designed by the artists of Lenox and created exclusively under their direction by master craftsmen in Japan, each figurine is individually crafted of the finest bisque porcelain – capturing *extraordinary detail* from the delicate lace-and-ruffle bodice to the gently scalloped petticoat.

Skilled artisans paint each piece *by hand*, creating a delicately colored work of art of incomparable beauty. And each figurine is embellished on its base in *pure 24 karat gold* with the title and the world-famous Lenox® trademark . . . the symbol of unsurpassed quality and craftsmanship.

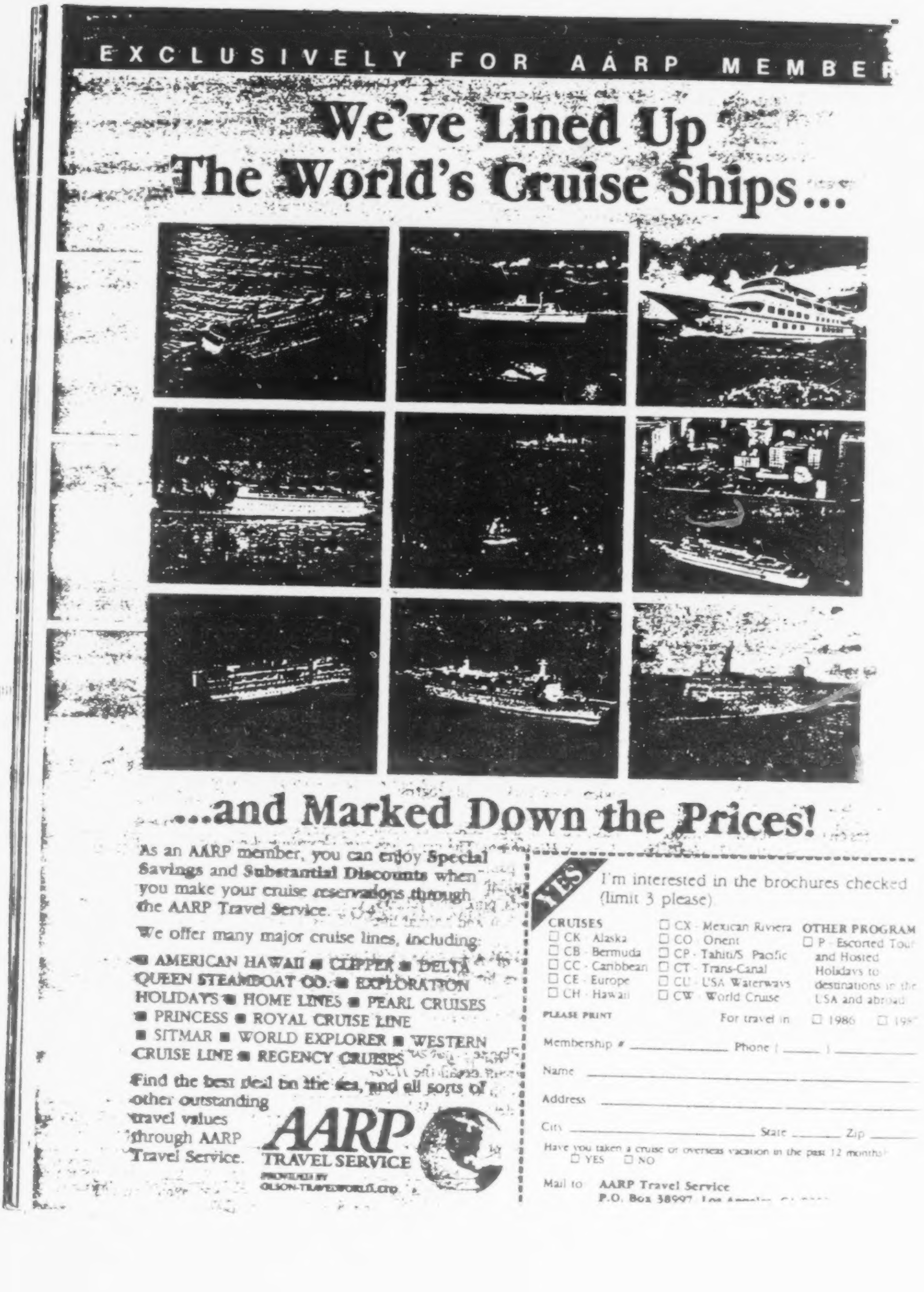
And, of course, your satisfaction is *completely guaranteed.*

Available Only Direct from Lenox

First Waltz is available only by reservation direct from Lenox and will not be sold through even the most prestigious dealers or galleries. The original issue price is $95, payable in convenient monthly installments of $19 with *no finance charge.* Each figurine is accompanied by a Certificate of Authenticity and literature on the history of American fashion.

Since each figurine is individually handcrafted, please allow 6 to 8 weeks for shipment. Reservations are accepted in strict sequence of receipt and should be received by October 31, 1986. To order, simply mail the attached postage-paid Reservation Application, or call our toll-free number below.

FOR YOUR CONVENIENCE, CALL TOLL-FREE 1-800-228-5000.



EXCLUSIVELY FOR AARP MEMBE

We've Lined Up The World's Cruise Ships...

...and Marked Down the Prices!

As an AARP member, you can enjoy **Special Savings** and **Substantial Discounts** when you make your cruise reservations through the AARP Travel Service.

We offer many major cruise lines, including:

■ AMERICAN HAWAII ■ CLIPPER ■ DELTA QUEEN STEAMBOAT CO. ■ EXPLORATION HOLIDAYS ■ HOME LINES ■ PEARL CRUISES ■ PRINCESS ■ ROYAL CRUISE LINE ■ SITMAR ■ WORLD EXPLORER ■ WESTERN CRUISE LINE ■ REGENCY CRUISES

Find the best deal on the sea, and all sorts of other outstanding travel values through AARP Travel Service.

AARP TRAVEL SERVICE
PROVIDED BY
OLSON-TRAVELWORLD, LTD

YES I'm interested in the brochures checked (limit 3 please).

CRUISES		OTHER PROGRAM
☐ CK - Alaska	☐ CX - Mexican Riviera	☐ P - Escorted Tou and Hosted Holidays to destinations in the USA and abroad
☐ CB - Bermuda	☐ CO - Orient	
☐ CC - Caribbean	☐ CP - Tahiti/S. Pacific	
☐ CE - Europe	☐ CT - Trans-Canal	
☐ CH - Hawaii	☐ CU - USA Waterways	
	☐ CW - World Cruise	

PLEASE PRINT For travel in ☐ 1986 ☐ 19

Membership # ______________ Phone (_____) ____________

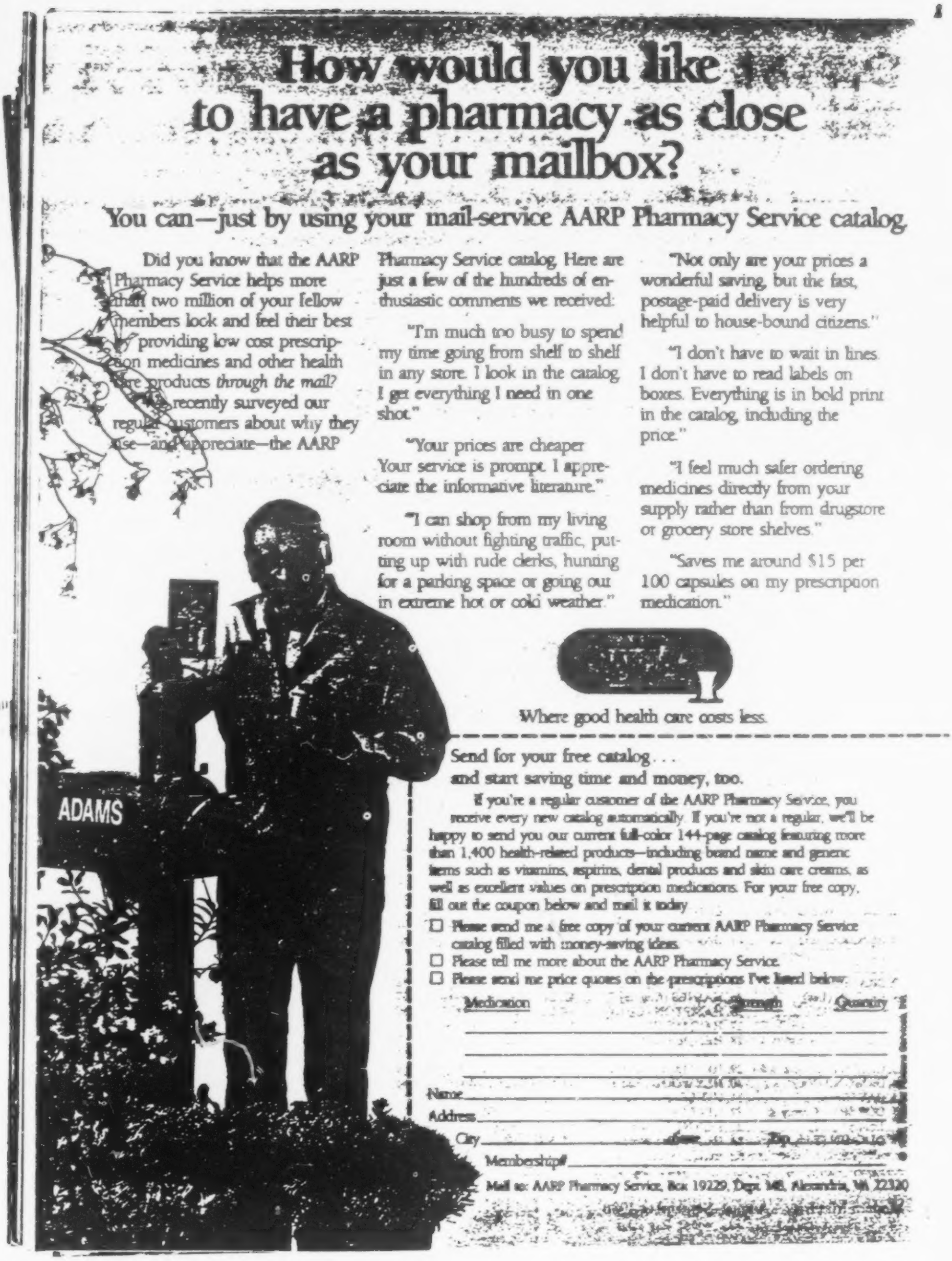
Name ______________________________

Address ______________________________

City ______________ State ______ Zip ______

Have you taken a cruise or overseas vacation in the past 12 months?
☐ YES ☐ NO

Mail to: **AARP Travel Service**
P.O. Box 38997, Los Angeles, CA



How would you like to have a pharmacy as close as your mailbox?

You can—just by using your mail-service AARP Pharmacy Service catalog.

Did you know that the AARP Pharmacy Service helps more than two million of your fellow members look and feel their best by providing low cost prescription medicines and other health care products *through the mail?* We recently surveyed our regular customers about why they use—and appreciate—the AARP Pharmacy Service catalog. Here are just a few of the hundreds of enthusiastic comments we received:

"I'm much too busy to spend my time going from shelf to shelf in any store. I look in the catalog, I get everything I need in one shot."

"Your prices are cheaper. Your service is prompt. I appreciate the informative literature."

"I can shop from my living room without fighting traffic, putting up with rude clerks, hunting for a parking space or going out in extreme hot or cold weather."

"Not only are your prices a wonderful saving, but the fast, postage-paid delivery is very helpful to house-bound citizens."

"I don't have to wait in lines. I don't have to read labels on boxes. Everything is in bold print in the catalog, including the price."

"I feel much safer ordering medicines directly from your supply rather than from drugstore or grocery store shelves."

"Saves me around $15 per 100 capsules on my prescription medication."

Where good health care costs less.

Send for your free catalog . . .
and start saving time and money, too.

If you're a regular customer of the AARP Pharmacy Service, you receive every new catalog automatically. If you're not a regular, we'll be happy to send you our current full-color 144-page catalog featuring more than 1,400 health-related products—including brand name and generic items such as vitamins, aspirins, dental products and skin care creams, as well as excellent values on prescription medications. For your free copy, fill out the coupon below and mail it today.

☐ Please send me a free copy of your current AARP Pharmacy Service catalog filled with money-saving ideas.
☐ Please tell me more about the AARP Pharmacy Service.
☐ Please send me price quotes on the prescriptions I've listed below.

Medication	Strength	Quantity

Name ______________________________

Address ______________________________

City ______________ State ______ Zip ______

Membership# ______________________________

Mail to: AARP Pharmacy Service, Box 19229, Dept. MB, Alexandria, VA 22320

What should I do?

continued from page 82

who may be as much as 50 feet away from the telephone.

Cost for these devices ranges from $90 to $900 with monthly service charges of $10 to $18. Some companies offer leasing arrangements.

The U.S. Post Office offers a free carrier-alert program whereby postal carriers monitor designated individuals for obvious problems by watching their mail activity.

If you decide to install an emergency device, proceed cautiously. The company you select should have a good service record. This is particularly important since a large number of firms will be entering this field in the next few years and may not be well managed or funded. Companies should offer quick replacement or repair of equipment; emergency hand transmitters should have a range of 100 feet or more and not be hindered by walls or furniture. A transmitter should not be so large it won't be worn, or so small it will be forgotten.

You might want to check with your local senior center, hospital, fire department, or Area Agency on Aging to see what systems are in operation in your area. Also, AARP and Scott, Foresman and Company have published *The Gadget Book*, which lists suppliers of medical-alert systems. *The Gadget Book* is available from AARP Books/Scott, Foresman and Co, 400 S Edward St, Mount Prospect, IL 60056. Price to members is $7.95 (nonmembers $10.95), plus $1.75 shipping. ■

If you have a question on coping with the problems that confront older people in America today, address it to: What Should I Do?, Modern Maturity, 3200 E Carson St, Lakewood, CA 90712. We regret it will not be possible to answer questions except on these pages.

IF YOU WERE BORN BEFORE 1937, YOU QUALIFY FOR 10 VALUABLE BENEFITS.

If you're 50 or over, retired or not, you're invited to join with over 22 million other mature Americans in enjoying these 10 benefits of AARP membership.

1. Modern Maturity magazine. Every other month, you'll read about everything from money and health to travel and hobbies.

2. Nonprofit Pharmacy Service. Save on brand name and generic drugs which can be ordered by mail from AARP's pharmacy service.

3. Your voice in Washington. The American Association of Retired Persons is leading the fight to get you a better break on everything from pensions to taxes to health care.

4. News Bulletin. Timely reports on legislative developments, fellow members and more.

5. Insurance Programs. You're eligible for quality group health coverage provided by The Prudential, plus auto and home coverage from The Hartford.

6. Travel savings and service. Your membership gets you discounts at major hotel, motel and rental car chains. And the AARP Travel Service provides preplanned travel programs around the world or around the corner.

7. Free Publications. A series of helpful booklets on finances, housing, health, taxes, energy conservation and more.

8. Investment opportunity. The AARP Investment Program offers a wide selection of no-load mutual funds.

9. Motoring plan. A specially-priced plan that includes emergency road service through Amoco.

10. Community activities. You'll be invited to join one of AARP's 3,400 local chapters.

Join AARP now for just $5, and let us help you get more out of your mature years.

YES! START MY MEMBERSHIP IN AARP FOR:
☐ One year/$5
☐ Three years/$12.50 Save $2.50!
☐ Ten years/$35 Save $15!

Name
Address Apt.
City
State Zip
____ / ____ / ____
Date of Birth RUAF

☐ Check or money order enclosed, payable to AARP. (Send no cash, please.)
☐ Bill me.
☐ If you're in or retired from education, check here and join the NRTA Division of AARP. RUNH

AARP Membership also includes spouse. 65% of dues is for Association publications. Dues outside U.S. domestic mail limits: $7/one year, $18/three years. Please allow 3 to 6 weeks for receipt of membership kit.

Mail to AARP, Membership Processing Center, P.O. Box 199
Long Beach, CA 90801

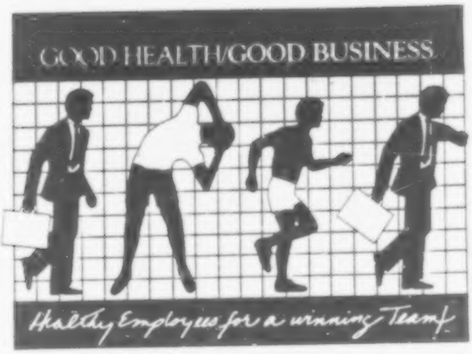
Homeowners Insurance Program
or for the extra-special service?

COMPARE COSTS AND BENEFITS
—WITH NO OBLIGATION

[illegible] the attached [illegible] 1-800-423-4114, [illegible] Eastern Time [illegible] the attached [illegible]

AARP HOMEOWNERS INSURANCE PROGRAM
THE HARTFORD
[illegible]

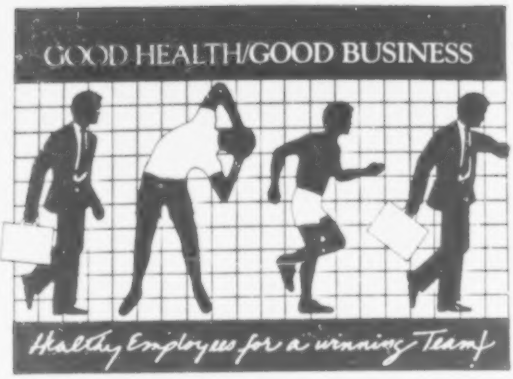
[illegible]


GOOD HEALTH/GOOD BUSINESS
Healthy Employees for a winning Team

▶ Sponsored by YMCA and Blue Shield

☐ BAY AREA YMCA ROSTER

YMCA	ADDRESS	PHONE #	CONTACT PERSON(S)
Central YMCA	220 Golden Gate Ave. San Francisco, CA 94102	415-885-0460	Stan Pedzick
Embarcadero YMCA	166 The Embarcadero San Francisco,CA 94105	415-392-2191	Ed Ducazau
Peninsula YMCA	240 El Camino Real San Mateo, CA 94401	415-342-5228	Karen Robinson
Chinatown YMCA	855 Sacramento St. San Francisco, CA 94108	415-982-4412	Alan Wong Tom Spry
Berkeley YMCA	2001 Allston Way Berdeley, CA 94704	415-848-6800	Tahirih Robinson
Mt. Diablo Region YMCA	350 Civic Dr. Pleasant Hill, CA 94523	415-687-8900	Lanny Couvillon
Oakland YMCA	2350 Broadway Oakland, CA 94612	415-451-8033	Larry Bush
Palo Alto YMCA	3412 Ross Rd. Palo Alto, CA 94303	415-494-1883	Valerie Rieheld
Palo Alto Fitness Center (YMCA)	755 Page Mill Rd. Bldg. B Palo Alto, CA 94301	415-858-0661	Tracy Palmer
Santa Clara Valley YMCA	1717 The Alameda San Jose, CA 95126	408-298-1717	Barbara Fisher
Sonoma County YMCA	1111 College Ave. Santa Rosa, CA 95405	707-545-9622	John Decker

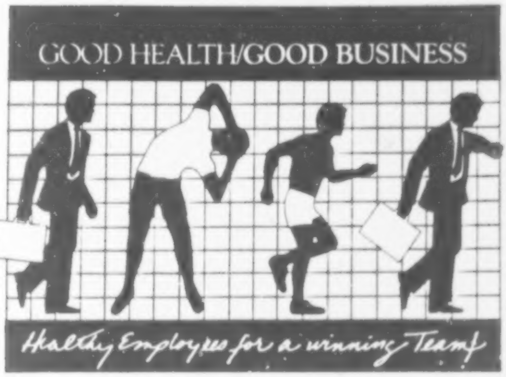

GOOD HEALTH/GOOD BUSINESS
Healthy Employees for a winning Team

▶ Sponsored by YMCA and Blue Shield

☐ BAY AREA YMCA CORPORATE BENEFACTORS

ALUMAX
ARCO
BAIN & CO
BANKAMERICA FOUNDATION
BLUE SHIELD
BANK OF AMERICA
CASTLE & COOKE
CHARLES SCHWAB & CO
CHEVRON USA
CONSOLIDATED CAPITAL
COOPERS & LYBRAND
CROCKER NATIONAL BANK
CROWLEY MARITIME
CROWN ZELLERBACH
DEL MONTE
DINNER LEVISON
ERNST & whinney
FIREMAN'S FUND
FIRST INTERSTATE BANK
FLEISCHMAN FIELD RESEARCH
GENSTAR
GERALD HINES INTERESTS
GOLDMAN SACHS
GUY F. ATKINSON CO.
HAYES PARK LAUNDRY
HEWLETT PACKARD
IBM
JOHN LEWIS INSURANCE
KIWANIS CLUB OF SAN FRANCISCO
KRON-TV
KUAN LOEB
LEHMAN BROTHERS
LEVI STRAUSS
MCKESSON CORPORATION
MERVYN'S
MICRO PRO INTERNATIONAL
MURRAY ENTERPRISES
NATOMAS
NEELEY/LOFRANO
PACIFIC TELEPHONE
PEAT, MARWICK & MITCHELL
PG&E
SAGA
SAN FRANCISCO ROTARY CLUB
SECURITY PACKFIC BANK
SHAKLEE
SOUTHERN PACIFIC
THOMAS BROTHERS MAPS
TRANSAMERICA
U.S. LEASING INTERNATIONAL

(Partial Listing)


GOOD HEALTH/GOOD BUSINESS
Healthy Employees for a winning Team

▶ Sponsored by YMCA and Blue Shield

☐ AGENDA

SYMPOSIUM ON CORPORATE HEALTH ENHANCEMENT

	REGISTRATION	
10:00 a.m.	WELCOME	ANDY DOLICH VICE PRESIDENT BUSINESS OPERATIONS OAKLAND ATHLETICS BASEBALL COMPANY
	BAY AREA YMCA ASSOCIATIONS INTRODUCTIONS	DAN OCHS DIRECTOR OF CORPORATE FITNESS SAN FRANCISCO METROPOLITAN YMCA
	HEALTH CARE PROMOTION: STATE-OF-THE-ART	DR. JAMES F. FRIES ASSOCIATE PROFESSOR STANFORD UNIVERSITY SCHOOL OF MEDICINE
	THE YMCA AS PROVIDER OF CORPORATE HEALTH & WELLNESS	CHARLES L. PARCELL SENIOR VICE PRESIDENT BLUE SHIELD OF CALIFORNIA
		S.T. JACK BRIGHAM, III VICE PRESIDENT, GENERAL COUNSEL & SECRETARY HEWLETT PACKARD
		GISELA NORWOOD SENIOR EDUCATION SPECIALIST IBM
11:20 a.m.	LUNCH	YMCA ASSOCIATIONS AND CORPORATE GROUPINGS
11:55 a.m.	LEAVE FOR OAKLAND COLISEUM	
12:15 p.m.	OAKLAND ATHLETICS VS DETROIT TIGERS	

Mr. **Flippo**. Thank you very much for your testimony and the specifics that you offered us. Let me ask Mr. Feldman, since the Supreme Court's decision in the *American College of Physicians*, you are very familiar with that decision, I am sure, do you feel that that Supreme Court decision clarifies once and for all when advertising income is subject to the unrelated business income tax?

Mr. **Feldman**. The answer, sir, is that it clarifies that advertising, as it appears in practically every tax exempt journal in the country is taxable. That resolved that situation which involved scientific advertisements, with a lot of technical information in them, advertisements, which I might add, also appear in for-profit medical journals. And the Supreme Court said even in advertisements like that, which no doubt carry very scientific kinds of information, that is taxable.

Congress decided in 1969 that that sort of thing was taxable. The problem has come in, I guess is an old story in trying to collect the tax because circulation income remains exempt. IRS properly has attempted to allocate the circulation from the advertising income—separate the two, and then provide a way that expenses pertaining to one are kept apart from the expenses pertaining to the other. This has caused nothing but problems. There is major litigation going on in Chicago right now between the American Medical Association and IRS. I will be glad to discuss it at further length with the staff of the committee. It provides a case example of a situation where AMA candidly admits it grossed $8 million a year from advertising, yet it claims it owes absolutely no tax because it is able to writeoff a lot of association expense against advertising income. I do not want to get into the details of the case, but major problems exist because of this duality that we have in circulation and advertising.

Mr. **Flippo**. Thank you for your response. I would like to ask each member of the panel, most of the discussions that we have had, involved the Tax Code. Could you identify problems outside of the Tax Code that impacts this unfair competition area? We have not had much testimony about other factors other than the Tax Code. If any member of the panel would care to respond to that.

Mr. **Feldman**. If I could respond to that, sir. Since 1971, over $11 billion has been spent from the Federal Treasury to subsidize postage rates of nonprofit organizations. Congress votes on that every year through an appropriation bill. Part of it is in the basic postal statute that the costs, which nonprofit organizations have to meet, in their handling of the post office, are limited to a certain percentage. When Gramm-Rudman was passed, the ceiling, you might say, was breached and Congress actually did cut the subsidy. But it is still a substantial amount and what is of concern, I would say in the publishing industry now, and other areas of business which use the mail is that as postal appropriations gradually wind down, because of budget restraints, there is a very real possibility, based on legislation contained in the 1986 budget resolution that postal rates paid by the average citizen, for example, the first-class rate, but other rates too, may actually cross-subsidize nonprofit rates.

This would mean, therefore, that people in the direct mail business would be cross-subsidizing tax exempt organizations that sell products at subsidized postal rates. Taxpaying publishers who compete against tax exempt publishers, would be cross-subsidizing competitors. And average citizens would be supporting groups that he or she may not wish to voluntarily contribute to which, of course, they are free to do and take the tax deduction for it, if they so choose. So that is a major, major problem that we foresee.

Mr. FLIPPO. How about in the small business area, nonpublishing?

Mr. SATAGAJ. I think, in addition to that, of course, there are the local and State taxes, property tax, sales tax. One of the most significant ones, which I mentioned earlier, is this concept of a halo effect. It is a benefit. It is an item or service that you are buying from a nonprofit; therefore, it is a better product. Even if the for-profit and the nonprofit are offering it at the exact same price, the public will go to go to the nonprofit to buy it. It is hard to attribute to a particular item the cause of the halo effect. I suspect that if you did not have the tax exemption or the subsidized postal rates, you probably would not be a nonprofit and therefore, you would not have the halo effect. It is hard to separate the effect out as a separate item, but it is probably the most significant, as we go on through this process. The halo effect is what gets the people into a nonprofit.

Mr. FLIPPO. Ms. Reed?

Ms. REED. I sort of see that halo affect as being dollars and cents, that there is no separation. And if you consider the fact that when a nonprofit organization decides to consider entering into competition with an existing industry, which is composed primarily of taxpaying businesses, they are making the same profit decisions as a for-profit person made before they went into that business. They are determining whether they can enter into the market on a profitable basis and they will not enter a market that they cannot perceive a profit. And let me lay out, maybe, a few of the things that take a nonprofit as opposed to a business person, what the differences are.

A businessman, when he sets up his business, has to go get a license and permits and pay all the taxes to the city, State, county, whatever it is. He has to find a place, rent his office. He has plant costs. He has to buy his equipment. He has to hire personnel, inventory, and he has not got a name that everybody recognizes. On the other hand, a nonprofit, if they pick up a business such as my own, which happens to be hearing aids, they do not need a license, they do not need permits. They already have a plant. They have equipment that has been donated to you and I can tell you much of that is very expensive. They have no payroll costs but they have a halo.

The difference being, if I provided some kind of charitable service, then maybe I ought to be a nonprofit and then add a charity name behind my name.

Mr. FLIPPO. We may have coined a new phrase today—a halo tax. Mr. Chairman, would you have questions, Mr. Pickle?

Chairman PICKLE. Well, first, Ms. Gallagher, or Ms. Reed, which is it?

Ms. REED. Ms. Reed.

Chairman PICKLE. I noticed that you gave, in your testimony, some specific examples of some unfair practices that have been going on out there. It was not in your original testimony that we had received. I am glad to have those examples and I wish you would furnish us additional examples. If what you describe is that prevelant, then we need to see examples and this would be true of any of you gentlemen.

Ms. Reed. I will be very happy to.

Chairman Pickle. We are trying to see just who has been hurt, not in theory alone, but actually who has been hurt in dollars and cents. Now, Ms. Reed, you said that you did not think we were going to get much help out of the recommendations that Treasury had recommended. They had made seven different suggestions in certain areas. At least we got seven suggestions from Treasury. We did not get anything from IRS that I can remember. Now, can you tell me why, other than to say they do not go far enough, specifically what would you require, as a matter of correction, in either the law or in the approach that this committee could take. If Treasury does not go far enough, in what areas would you go stronger or what do you want us to give you in the way of relief?

Ms. Reed. Being much more learned than myself, I hope that you would be able to separate out the abuses of the tax exempt status that is going on. And those abuses that I pay taxes on, the areas that I pay taxes on now and that I am not able to take advantage of as a business person, you would hopefully find those. Did I answer your question?

Chairman Pickle. Well, not helpfully. And if you, Mr. Satagaj, or Mr. Feldman, either one, have got any specific suggestions as to what we could do to strengthen these recommendations, or bring in new ones, we would be glad to have your recommendations. That is what we are looking for. Do you have any suggestions today?

Mr. Feldman. No, sir, but we will be glad to submit anything we do have. I do want to say, just very briefly, that in the areas we have discussed in advertising income and publishing, IRS has been doing its best to enforce the tax. They have been hit with an ingenious array of arguments and an ingenious army of lawyers. Tax exempt organizations do not stint when it comes to getting competent counsel and I do not suggest that they should. But IRS has had its hands full on this and on that aspect of the UBIT, we would like to commend them. They are doing their best. They do not always prevail, but not every lawsuit can be won. It is getting so complicated, though, that it may be time for Congress to cut the Gordian Knot.

Chairman Pickle. If either of you have some other suggestions for us, we would be glad to receive them.

Mr. Satagaj. Mr. Chairman, if I might just add? On the first day, the Business Coalition of Fair Competition, and also, Frank Swain from the chief counsel's office, had a number of proposals, the thrust of which was to create an affirmative responsibility on the nonprofit if they are going to get into some activity that is commercial in nature. And you can use an additional, maybe, three or four criteria. If they are in that activity. There is an affirmative presumption that it is a commercial activity. Let them demonstrate that there is, in fact, a need to continue that activity despite the fact it is commercial in nature.

So our recommendations would go along the lines of both what Mr. Swain presented and also with that of the Business Coalition of Fair Competition. It is accountability. I think the one thing that Commissioner Gibbs did say that day, and I agree with you, he did not give any specifics, he did mention the word accountability. I believe either Commissioner Gibbs or Mr. Chapoton mentioned accountability a lot in their testimony and that is what we are really saying. Make them be affirmatively accountable. We do not say eliminate the activity, but let them demonstrate the reason for it.

Chairman **Pickle**. I thank you. That is a good point. Thank you.

Mr. **Satagaj**. Thank you, Mr. Chairman.

Chairman **Pickle**. Thank you, Mr. Chairman.

Mr. **Flippo**. Thank you. Mr. Thomas?

Mr. **Thomas**. Thank you, Mr. Chairman. I apologize for not being here through most of the testimony. We always have to be in three places at once. Mr. Feldman, for a minute or two, because I do not pretend to understand the business of periodicals and the advertising and the way in which they have to play Solomon with themselves, in terms of judgments that are made. It is probably easier with a narrow kind of publication than it would be with National Geographic or Smithsonian where, you know, they wind up advertising the country store pillows, porcelain objects, Franklin Mint, that sort of thing. I assume they pay UBIT on any of those commercial kinds of ads that run. You know, National Geographic always has an automobile ad up front.

Mr. **Feldman**. Yes, well, National Geographic has a Toyota ad on the back cover here. But the tax is supposed to work in a very simple way, exactly the way you described it.

Mr. **Thomas**. Did National Geographic used to have ads on the back page?

Mr. **Feldman**. I do not know, sir. I could not——

Mr. **Thomas**. I thought they did not.

Mr. **Feldman**. I do not know. But technically, it is supposed to work that the advertising is treated just like the advertising in a for-profit journal. It is a very simple concept which the business press certainly supports. The problem is that while the circulation income is exempt, the accounting regulations permit the deduction of circulation expenses. In other words, the salary of the editor can be deducted against the advertising income and you get into very complicated things about who is working for the magazine, who is working for the association, where do you draw the line, and how much of the income and expense of the association as a whole should be attributed to the publication.

Mr. **Thomas**. My assumption is that it gets more difficult as the publication gets more narrow, in terms of its appeal because when does advertising stop and educational materials begin?

Mr. **Feldman**. Well, with all due respect, actually, I do not think that really is a problem.

Mr. **Thomas**. It is not?

Mr. **Feldman**. It is not. The reason is, is that publishers stand up to advertisers who want them to publish articles which are nothing but disguised ads. There are several kinds of checks on this. The Postal Service does a fairly good job. Obviously, things slip through the cracks, there are safeguards and, as I say, the Post Office is the

Federal safeguard and, I think, the integrity of editors, in both the tax exempt and for-profit sector, is the other one. I think you can take some comfort in that editors in this country know their responsibilities.

Mr. Thomas. Good. I am glad to know that someone has an internal governor. It seems as though some folks—and it is not just that. It is in defining your mission. Ms. Reed, I appreciate the specifics. We have had a lot of platitudes, but not a lot of specific examples. One of my concerns is, as we move through these hearings, is that what we are getting is, that there are people out there who are in the specific businesses themselves. You give the example of the Monterey Aquarium, with its cafeteria.

Well, obviously, the Cannery Row restaurant owners are the ones who will be most sensitive to the fact that Monterey has the cafeteria and we are sitting here expecting these folks, to the best of their ability, to play Solomon on themselves, as to what they file, whether or not it is a Form 990–T, what way they break it down, how they account for people in various professional positions. I believe one of the small business recommendations was that we set up some kind of a complaint forwarding and finding procedure. Have you discussed that among your members and is that something that you strongly advocate? Or do you think that most of these people are reporting in a way which is beneficial and useful and will allow for people to overview their activities?

Ms. Reed. Yes, sir, we do have requests for complaints and for people to write us testimony personally, but I will repeat that many business owners are fearful of coming forward and criticizing nonprofit corporations, for instance, nursing homes. They are not about to really say that a nonprofit organization is doing wrong since really the nonprofit corporation is the one that is sending them patients. And there are so many other examples. They are really fearful of coming forward.

Mr. Thomas. Well, you put us in a kind of a dilemma because we are not going to be able to write a specific law which says you cannot engage in some kind of a chargeable activity if a for-profit is already engaged in it. You just cannot draw those kinds of lines. If you allow some of these individuals to do the self-reporting, somehow whenever they draw the line, it is not where, perhaps, we would draw it. It tends to be somewhere else unless we get some kind of a reporting procedure which focuses the IRS or some other appropriate agency on the problem. It can be through some kind of a complaint procedure with a follow-up.

I guess what I am saying is you cannot have it both ways. If you are going to complain about some of the activities, we may have to talk about enlisting you folks in helping us to simply detect those kinds of activities. Because otherwise, relying on the system is going to continue to perpetuate it the way it is those who are totally honest and those who have scruples, go ahead and fill out the form. But others, given their view of what their mission is, broadly defined, feel perfectly comfortable in filling out the form the way they do, all lumped together without breaking it down. We can get specific on the form, but I do not see how we can address specific practices if the private for-profit sector is not willing to help us at least identify and channel information to the proper authorities for review purposes.

Ms. REED. Mr. Thomas, we will be very helpful in any way we can to you in providing that information.

Mr. THOMAS. No. 1, we need as many specific examples as we can so that we can determine the breadth and the depth of the kind of activities. We appreciate the specifics that you have brought us. Thank you very much.

Mr. FLIPPO. Thank you. I want to thank our panel for sharing their views and their time with us this morning. Our next panel, we are very pleased to have the president and chairman of the board of the National Geographic Society, Mr. Gilbert Grosvenor. Of the American Association of Retired Persons, we have the executive director, Cyril Brickfield; and the American Society of Association Executives, Rod Geer, vice chairman of the board. And I must say again how pleased we are that you would come and share your views. We recognize the difficulty of the subject matter. Your views are absolutely essential. We appreciate your willingness to come and discuss this with us. Why don't we start with Mr. Grosvenor and please give us your testimony and then we will proceed with the other members. Thank you.

STATEMENT OF GILBERT M. GROSVENOR, PRESIDENT AND CHAIRMAN OF THE BOARD, NATIONAL GEOGRAPHIC SOCIETY

Mr. GROSVENOR. Mr. Chairman, members of the committee. I am Gilbert M. Grosvenor, president of the National Geographic Society. I am here today at your invitation. The written statement I have submitted describes the history of the Society, its basic orientation as a membership organization, and its commitment to public education and public service. These factors are critical to an appreciation of our programs and I would hope that the committee has had the opportunity to review and to consider them. I understand that on Friday, you expressed to us a particular interest in the financial status of organizations appearing before you and, in specific, details of revenue generating activities. Accordingly, you have all received a supplemental statement that sets out the revenues and net income derived by the National Geographic Society.

We file a form 990-T and report all income from advertising. For 1986, these gross revenues were $31.5 million and the net income was $400,000. Taxable income is computed under a formula set out in Treasury regulations. For 1986, application of this formula to our advertising income, did not result in any tax liability because readership costs exceeded readership income. For some prior years, we have paid unrelated business tax on advertising income, although never in a substantial amount. The society is periodically audited by IRS, most recently, 3 years ago. In those audits, our methods of calculating tax liability, under the Treasury regulations, were approved and accepted and no other tax was imposed.

The society has no subsidiaries, either taxable or exempt. We have never entered into any partnerships with a for-profit entity, nor into any financial arrangement involving a shifting of benefits of tax exempt status. Our supplemental statement shows that the society pursues certain activities that generate net income and certain activities that result in a net loss. We believe that all of our activities, with the exception of advertising, are consistent with, and contribute to, the increase and diffusion of geographic knowledge.

I would be happy to respond to your questions about our programs, or to provide the committee with additional analyses or information. Although the scope of the society has expanded over its 99 year history, we enter new areas of geography education only with great care and considerable restraint. We have tried to avoid any unrelated business activities. Unrelated, either in the tax sense, or in our own institutional sense. The society consciously exercises self-restraint, both in the conduct of its activities and in the pricing and distribution of its services and products. We limit our activities to those which are editorial and choose to purchase paper and printing services from commercial companies. We offer our books and products, such as atlases and globes, in the United States and Canada, only to our members, notwithstanding the opportunities frequently presented to us for wider distribution and greater profit.

Our educational products available to schools are deliberately priced at the middle range of those markets. The society does not seek to maximize profits. We do not seek to promote or preserve any unfair competitive advantage. Indeed, we do not seek to compete at all with any organization or company that is already satisfying the need for information in a particular area. Throughout the 20th century, the society has restricted itself to increasing geographic knowledge and to providing educational resources to its members, to the general public, and to the Nation's schools.

The society is, in a very real sense, the genesis of a large and special market—the market for geographic education—that would not otherwise exist. The society has created substantial opportunities for the printing, manufacturing, and other businesses that actually produce our products. Of the society's total expenditures for 1986, 59 percent were payments to commercial businesses for their participation in our operations. Far from hindering competition, the society actually provides profit opportunities for businesses by stimulating, in our members, a demand for geography related products, services, and for educational travel, both domestic and foreign.

As I have explained in my written statement, the National Geographic Society cannot be understood other than as a membership society. And probably a unique one. We have built up in our members, a relationship of trust and sense of personal identification with the purposes of their society. It is the size and the loyalty of our membership that has given us the funds and the mandate to promote geography education within the broader public. Mr. Chairman, I urge you and your committee to judge the National Geographic Society and similar nonprofit organizations by function, rather than by size.

I have never seen an organization that is comparable to the National Geographic Society, and I do not believe that such an organization could evolve in a commercial atmosphere. In fact, given today's world, I do not think that any organization could replicate our time-tested traditions or carefully crafted editorial policies, our membership strength and loyalty, our commitment to geography education, and our extensive programs of research, exploration, and public service.

[The statement of Gilbert M. Grosvenor with an attachment follow:]

STATEMENT OF THE

NATIONAL GEOGRAPHIC SOCIETY

I am Gilbert M. Grosvenor, President of the National Geographic Society, and I am here today, at your invitation, to talk about the major activities of the Society.

The National Geographic Society was organized in 1888 by Gardiner Green Hubbard and a group of 32 prominent geographers, explorers and public-spirited citizens. They saw the Society as a means of "furthering the purpose of geographic research" and of "diffusing the knowledge so gained among men". For his inaugural address as first President of the Society, Hubbard chose a theme that has been mirrored in the activities of the Society for almost a hundred years:

> ... the Membership of our Society will not be confined to professional geographers, but will include the large number who, like myself, desire to promote special research by others, and to diffuse the knowledge so gained among men, so that we may all know more of the world upon which we live.

The National Geographic Society Serves The Interests of Its Members

The National Geographic has been, from its beginning and throughout its history, first and foremost a membership society. Our members are individuals and families who want to learn more and to understand more about the world in which we live. Some are ardent travelers; some cannot afford travel. Some are highly educated; others have had little formal education. All of our members, however, share a deep interest and a lively curiosity about this physical world.

Geography, I'm afraid, has suffered a great deal from the methods of geography teaching that were used when I, and many of you, were in elementary school. When it's poorly taught, geography is stiff and frozen, the stuff of memorization. When it's brought alive, however, geography is one of the richest and broadest of intellectual pursuits. It is also an important one. As the members of this Committee know all too well, we live on a shrinking planet. The realities of world trade, instant communication, and rapid transportation have made us all -- the city dweller and the hunter, the sophisticated and the primitive -- into near neighbors. We cannot be so interdependent and still be ignorant of who our neighbors are, how they live, why they think and act as they do. An understanding of geography thus plays a critical role in military and foreign policy decisions, in economics and trade. Equally it affects life at a much more immediate level, enhancing appreciation of art and culture, increasing the pleasure of travel. The National Geographic Society is concerned with geography at all these different levels, because our members are.

The Society's commitment to geography as a lively science is reflected first, of course, in the National Geographic magazine. The magazine has become, as the founders of the Society hoped, an educational publication that appeals to a wide audience while retaining standards of scholarship that apply to an academic publication. As the official journal of the Society, still retaining its familiar yellow-bordered cover, National Geographic has earned a world-wide reputation as a leading source of accurate, often definitive information about the world and its peoples. It remains the Society's prime means of fulfilling its mission of diffusing geographic knowledge.

Because the National Geographic is the primary link between the Society and its membership, the Society has long been committed to making the magazine available to members of the Society at the lowest possible price. Nearly 100 years after its founding, more than 10 million members of the National Geographic Society rely on the magazine to provide them with an accessible monthly educational resource for only $18 a year. Because of the depth and accuracy of the information as well as the care taken in using the highest quality materials for its publication, families and schools across the nation and the world collect and use these issues as a readily available resource. The magazine is designed to be timeless. It is an educational asset that for decades has broadened the horizons of Society members, many of whom have had no other sources of information that were both affordable and reliable.

As you may be aware, the National Geographic also publishes books on geography-related matters, selected on the basis of extensive membership surveys. These illustrated publications, on a range of subjects from ancient Greece and Rome to the exploration of space and modern China, are not commercially available in the United States and Canada. They are offered, by mail order, to our members.

Similarly, for our membership, the Society is involved in the production of first-rate maps, atlases and globes. The Society's cartographers are world-renowned for the quality of their maps, and since 1918 have been doing special supplements for the magazine. Four are produced each year. As with its books, the Society's maps, atlases and globes are provided as a service to its members and to the educational community. They are not offered to the general public.

Members of the National Geographic Society are curious, and through our magazine and books we attempt to stimulate that curiosity. Accordingly, to answer the questions that in many cases we raise, the Society maintains a research correspondence program for the benefit of our membership. Our Research Correspondence Division answers all mail that comes to the Society pertaining to the content of our publications and the direction of Society endeavors. Research Correspondence also acts as a resource for members when they need to find additional information on a particular subject. This Division has assisted countless numbers of students with information for school reports and projects. In 1986 alone, we answered 35,000 requests for information from Society members.

I don't believe that the National Geographic Society can be understood other than as a membership society -- and probably a unique one. For ninety-nine years we have built up in our members a relationship of trust. If you read it in National Geographic, our members believe, it's accurate. That confidence in the Society is reflected in a 1986 membership renewal rate of 86%.

The more than 10 million members of the Society support an organization of which they feel a part. I report to them monthly through the magazine's President's Page, and through the pages of the Members Forum they tell us their views on the Society's efforts and new undertakings. The numbers and the loyalty of our members and their personal identification with the Society give us the funds and the mandate to further the knowledge of geography and geography education within the broader public.

The National Geographic Society is Committed to Public Service and Education

With the support of its membership, the National Geographic Society has pursued in a variety of ways its mandate to increase and diffuse geographic knowledge. Almost from its very beginning, the Society through its Research Committee has sponsored expeditions and research projects. The first National Geographic expedition, in 1890 and 1891, explored and mapped Mount St. Elias along the then unknown border of southern Alaska and Canada, and discovered Canada's highest peak, 19,850 foot Mount Logan.

National Geographic grants helped Robert E. Peary to reach the North Pole, Richard E. Byrd to fly over the South Pole, and an Army Air Corps stratosphere balloon to set an altitude record of 72,395 feet that stood for 21 years. These particular feats combined science with adventurous exploration, and certainly produced some of the more thrilling of our magazine issues. The Society, however, has consistently supported pure science as well. One of the most significant of our projects was the enormous effort, co-sponsored by the California Institute of Technology, to achieve a systematic photomapping of the night skies, revealing objects up to one billion light-years distant, including tens of thousands of vast, remote clusters of galaxies.

The Society's Committee for Research and Exploration, operating since 1890, is made up of distinguished experts who, with a budget of $5 million a year, evaluate and fund research proposals. Aided by National Geographic grants, for example, the Leakey family of Africa has helped uncover man's deepest past, and Donald C. Johanson has unearthed the three-million-year-old skeleton dubbed "Lucy." Field studies by three researchers have revealed hitherto unknown facts about primates: Jane Goodall with chimpanzees; Birute M.F. Galdikas with orangutans; and the late Dian Fossey with gorillas. The search for early man in the New World has been carried out in several major projects. Research grants have helped to uncover the buried city of Aphrodisias, and to study skeletons of victims of the wrath of Vesuvius at Herculaneum.

National Geographic research projects, totalling 3200, encompass a broad range of geography that includes geology, paleontology, geophysics, oceanography, biology, anthropology, ethnology and geographic exploration. This is research at a much more technical and detailed level than most laymen could appreciate, and indeed only about 2% of these research reports are used as the basis for articles in National Geographic magazine. Instead, results of many of these projects are reported in the quarterly Research Journal, a publication directed to the university community. The National Geographic Society has thus helped hundreds of scientists in adding to the body of geographic knowledge.

The Society also has a long history of public service and education. Following our earliest traditions, we provide a number of services to the Washington community and its visitors. Annual lecture series in our auditorium and in Constitution Hall have since 1933 highlighted world cultures. Numerous school groups come to Explorers Hall at the Society's Washington headquarters to see demonstrations on our huge movable globe that illustrate basic geography. At this free museum (open seven days a week to members and visitors from around the world -- a total of 360,000 in 1986), the Society routinely mounts exhibits on subjects ranging from early man to space exploration. Currently, we have an extensive exhibit on wolves in this museum. In conjunction with this exhibit, we hosted an international conference on preservation of this species.

As a public service, the National Geographic contributes the services of editors, writers, and photographers to publish official guides to the White House, the United States Capitol, the Supreme Court, and the Washington Monument. Another public-service book, on the Statue of Liberty, is helping to raise money for a restoration and preservation of that monument.

The Society maintains an extensive research library of books (78,000 volumes), magazines, atlases, periodicals, and press clippings, which is open to the public. We have created what I think is an imaginative and effective children's magazine of geography, called World, which is available to the public, and an educational travel resource in the form of Traveler magazine. To keep the general public informed on new geographic advances, the Society provides news features and photos free of charge to more than 2,500 subscribers and other media outlets. We also provide free to stations across the country a weekly radio broadcast on topical geographic subjects.

Over twenty years ago, the Society made what was then considered to be a bold leap, and brought geography education into a new dimension. We began producing television documentaries. National Geographic Specials have become the standard by which other fine educational documentary series that now regularly appear as public television fare are measured. Our Specials (four hour-long documentaries each season) have won dozens of awards, including the Peabody Prize for "outstanding television education." I might note that over a period of two decades we carried a $12,258,000 cumulative loss on our television operations.

Two years ago, we began to introduce our older Specials into television syndication and the home video market. We have also now entered cable television with National Geographic EXPLORER, two hour documentaries on science, natural history, travel, adventure and history that appear weekly on WTBS.

Why is the Society increasing its television involvement? Simply put, the Society has changed as times have changed. Since our founding, we have made every effort to stay in the forefront of technological research and development, placing it at the service of geography education. For our members we have pioneered in photojournalism; for the community at large we have pioneered in television documentaries. The printed word, after all, does not have an exclusive lock on education. Though we remain primarily committed to serving our members' educational needs, we believe that our television documentaries are an important and logical extension of our commitment to educating the general public.

In much the same vein, we began in 1972 to focus on the classroom and what we perceived as a dearth of high-quality audio-visual materials. As with television, we believed that our expertise in education through pictures could make a difference. We now produce filmstrips, films and multimedia kits related to science and social studies topics, and we have just introduced a small line of computer software products. National Geographic is involved in a National Science Foundation-sponsored project that uses a telecommunications network to send results of local classroom earth science geography experiments from around the country to a central computer that pools data and sends back combined national results. With Apple Computer and Lucasfilm, we are working on the development of a multimedia educational system using a computer, a videodisc player and a custom videodisc.

The computer network and the interactive videodisc are new collaborations that hold out great promise for innovative classroom applications of high technology. We are involved because these new systems, if successful, will be much more effective than any present tools for the teaching of geography in the classroom. We recognize that if such systems ever make money it will be, as it was with our television documentaries, many years in the future. National Geographic did not initiate these pursuits for profit. They began because of our belief that to learn geography in a technological age, our students must have sophisticated, technological resources. I am convinced that the television monitor, the computer, and the telephone are destined to transform the way we learn, and the way we teach. I should add, however, that we also recognize that long after filmstrips are passe, some schools will still want to order them, because the projector will still be the only audio-visual aid available to their teachers. For those schools, National Geographic will still be providing the appropriate educational products, because that, too, is an important part of our public service outreach.

The National Geographic Society Recognizes Its Obligations Within the Tax System

The National Geographic Society recognizes that, along with other charitable, educational and scientific organizations, it occupies a privileged position in the Federal income tax system. We have been conscious that this privilege implies responsibilities, and we have taken these responsibilities seriously. We have conscientiously tried to avoid becoming involved in any unrelated business activities, other than magazine advertising which is of course subject to tax.

The Society is sensitive not only to the technical requirements of the tax law but to the concerns that it reflects. We are particularly sensitive to possible issues of unfair competition. The Society consistently and consciously exercises self-restraint, both in the conduct of its activities and in the pricing and distribution of its services and products. In our various publication efforts we limit our activities to those which are editorial, and continue to purchase paper and printing services from commercial companies. We limit the offering of our books and of products such as atlases and globes in the United States and Canada to our members -- notwithstanding the opportunities frequently presented to us for wider distribution and greater profit. For educational products that we make available to schools, we deliberately set our prices at the middle range of products sold in those markets.

Since the interests of the National Geographic Society are not in maximizing profits, we do not seek to promote or preserve any unfair competitive advantage. Indeed, we do not seek to compete at all, whether fairly or unfairly, with any organization or company that is already satisfying the need for information in a particular area. What the Society has attempted to do over its long history is to fill gaps in the body of knowledge as to geography, and to supplement the educational processes and resources otherwise available to its members and to the general public. Our educational mission should not be inconsistent in any way with the tax policy objectives of this Committee, and the Society is prepared to accept and to comply with any changes in the tax law you may decide upon.

The National Geographic Society Continues to Grow in Response to the Needs of Its Members and Its Society

I've tried to focus in this testimony, however briefly, upon what we believe to be an unusual blend of membership orientation and public service commitment. Perhaps one example would serve to illustrate the efforts of the Society, with the encouragement of its members, to respond to a changing universe.

Several years ago, we became concerned that we were ignoring a core problem in geography education -- an ignorance of basic geography concepts in our youth. I wrote of my concerns over the lack of geographic competence among our nation's children in the President's Page of the June, 1985, issue of National Geographic magazine. That one column received more member responses than any President's page published in the history of the Society. I was given a clear mandate, later confirmed by our Board of Trustees, to establish a large public service program targeting elementary and secondary students and teachers, designed to improve the teaching and understanding of geography.

The result of the Society's initiative and our members' response was the Geography Education Program, begun more than two years ago and funded in excess of $4 million a year. The Program now involves 15 geographic alliances in 13 states and the District of Columbia, which bring together elementary and secondary school teachers, university faculty, and public policymakers to implement local curriculum changes directed at improvements in the teaching of geography.

What does this mean? Let me use Texas as an example. Last year, we established a Texas Geographic Alliance at Southwest Texas State University and Texas A&M University, working in cooperation with the Texas Education Agency. Key geographers at these universities set up programs, with our assistance, to promote geographic education in their locales. As it happened, educational reform measures in Texas had mandated that world geography be offered as an alternative to world history. Unfortunately many school districts could not fulfill this mandate, because so few teachers had sufficient background in geography. Accordingly, last year we brought a number of Texas teachers to Washington for a four-week institute in geography teaching. This year, we will bring more Texas teachers here for a similar training course.

The four-week Summer Geography Institute, now in its second year, was established to bring to Washington sixty-five teachers from all alliance states (Alabama, California, Colorado, District of Columbia, Illinois, Kentucky, Minnesota, Missouri, New Jersey, North Carolina, Oregon, Tennessee, Texas and Virginia), in order to improve teachers' knowledge of geography and to enhance their teaching abilities. When these teachers return home, they share their knowledge through in-service workshops, which in turn increase the geographic knowledge of their peers. Through the alliance network, we also sponsor local geography institutes and workshops throughout the year. Our geographic alliances are supported with operating grants of up to $30,000 per year for a minimum of three years, and project grants of up to $50,000 per project (for institutes, curriculum conferences, materials development workshops, etc.). National Geographic provides the services of 15 of its staff people to the alliance program, and contributes many thousands of dollars worth of educational materials. Next year, we will expand our Geographic Alliance Network, and add seven more states.

Our Geography Education Program also involves the support of two pilot junior high school programs in Washington, D.C. and Los Angeles, California -- laboratories where we experiment with teaching materials and methods. In connection with another part of the program, we have published and distributed, free, more than six million specially prepared maps to secondary school students nationwide. These maps illustrate the five fundamental themes of geographic education as defined by the Association of American Geographers and the National Council for Geographic Education. Demand for these maps exceeded our expectations by 4,500,000.

To establish a baseline for our progress in the Geography Education Program, we have commissioned the National Assessment of Educational Progress (NAEP) to test the nation's 17-year-old seniors, to determine the level of their geographic knowledge. Once we have the results of the Assessment, we will be able to better develop and target instructional materials to respond to particular educational deficiencies. As I wrote to each member of Congress just a few weeks ago in support of the establishment of a national "Geography Awareness Week," I am convinced by polls and other evidence that there is a widespread lack of geographic literacy among our nation's students. That conviction is shared by the members of the National Geographic Society.

The Geography Education Program is only beginning its work. But we are bringing all our resources to bear on what I firmly believe is an education crisis in this country -- the crisis of geographic ignorance. That is what our members want.

Conclusion

I have attempted in this testimony today to describe a 99 year old organization that is still young and growing. Change over our first century has been evolutionary rather than revoluntary in nature. Population has boomed since our inception, and demographics have changed. But during this century, the Society has kept up with what our members want and need. I am very proud of that. The challenge today focuses on students and teachers. It is a different challenge than the one that occasioned the Society's founding, but no less a worthy one. The National Geographic Society is a part of the educational fabric of this nation. It responds to its members as they respond to their changing world. I look forward to fulfilling our mission in our second century as we seek to better educate our current and future citizens.

15a

NATIONAL GEOGRAPHIC SOCIETY

Supplemental Statement

Results of Operations
1986

EXEMPT OPERATIONS	Gross Revenue in Millions	Net in Millions
Membership Dues / Magazine	$185.7	$5.1
Books Sold to Members	42.2	4.3
Children's Books	24.0	(0.4)
World Children's Magazine	12.8	(0.3)
Traveler Magazine	11.1	(1.2)
Curriculum Audio Visual Materials	11.1	1.0
Cartographic Products	9.5	1.5
Calendars & Miscellaneous	7.0	1.5
Explorer (Cable TV Documentaries)	5.9	(1.0)
Videocassettes (PBS & Cable TV Documentaries)	2.2	0.9
Syndication (PBS & Cable TV Documentaries)	1.6	0.5
TV Specials (PBS Documentaries)	-	(1.5)
Lectures	0.2	(0.2)
Total From Exempt Operations	$313.2	$10.1
Research Grants & Public Service Programs		(12.5)
Net From Exempt Operations		($2.3)
INVESTMENT INCOME		
Interest & Dividends	$13.0	$13.0
UNRELATED BUSINESS ACTIVITIES		
Sale of Advertising Space	$31.5	$0.4

Mr. **Grosvenor**. Mr. Chairman, if I could be permitted, I would like to respond to a question of advertising that came up in the previous panel.

Mr. **Flippo**. Please do so.

Mr. **Grosvenor**. As I have indicated, we treat advertising income as unrelated business income. We calculate the tax under IRS regulations that are clear and precise. The IRS has audited our method of calculating tax under the regulations, and approved it. You may conclude that the present regulations do not accurately measure taxable income from advertising and that the IRS should change them. We will certainly comply with IRS regulations in any form and will pay any tax on our advertising income that is determined by those regulations. Thank you.

Mr. **Flippo**. Thank you.

Mr. Brickfield?

STATEMENT OF CYRIL F. BRICKFIELD, EXECUTIVE DIRECTOR, AMERICAN ASSOCIATION OF RETIRED PERSONS (AARP)

Mr. **Brickfield**. Mr. Flippo, and Chairman Pickle, my name is Cy Brickfield. I am the executive director of the American Association of Retired Persons.

We are pleased to be given the opportunity to appear before the subcommittee to describe how AARP fulfills the social welfare function which is the basis of its tax-exempt status under section 501(c)(4).

AARP derives support from five principal sources, which I will mention in the order of their magnitude, Mr. Chairman.

Its largest source of revenue is its membership dues, which are $5 per year per member. Including spouses, AARP has over 25 million members.

Its second largest source of revenue is from its group health insurance program. We receive an administrative allowance of approximately 4 percent of the premiums under this program. As part of an audit of AARP by the Internal Revenue Service in 1978, the revenue from this program was determined by the IRS to be substantially related to AARP's social welfare purposes. These activities, which are described in detail in my written presentation, satisfy an important need for older Americans. AARP has the unique position as the Nation's largest membership organization that represents and seeks to protect the interests of older Americans in this field, not only in obtaining the best contracts for them, but also in setting the standard for other group health insurance programs.

AARP's third largest source of revenue is Government grants. The largest such grant is from the U.S. Department of Labor to fund the Senior Community Service Employment Program. This program provides employment for economically disadvantaged persons age 55 and over. Another grant is received from the IRS in support of AARP's tax aid program. This program provides effective and free tax counseling to more than 1,250,000 persons, most of whom are low-income elderly.

AARP's fourth largest source of revenue is royalty and interest income, which categories of income are specifically nontaxable under current law. Over half of this income consists of royalties received from separate taxable entities that use the AARP name in offering quality goods and services to older persons. One example is the mail service pharmacy administered by the Retired Persons Services, Inc., which is a nonstock District of Columbia corporation. RPS and its subsidiaries are and have always been, however, fully taxable entities.

Lastly, AARP derives revenue from the sale of advertising in the two AARP periodicals distributed to the entire membership, and this advertising revenue is treated as unrelated business income, and I noticed that Mr. Grosvenor digressed from his written presentation to point out that National Geographic's advertising is also treated as unrelated income and is therefore taxable.

AARP has to date not incurred actual taxable liability with respect to this income because under the applicable regulations and rulings such liability does not arise where the organization's total periodical cost exceed its total periodical income.

So to recap, gentlemen, our primary sources of income are membership dues, an administrative allowance from substantially related group health insurance program, Government grants, and interest and royalty income—all of which are exempt from the unrelated business income tax. We receive advertising revenue which is treated as unrelated business income but has to date not resulted in a tax liability under the formula.

Now where does this revenue go? Over 84 percent of AARP's 1986 revenue went to four categories of expenses. They are, in order of magnitude, publications, member services and acquisition, the previously mentioned Government-supported grant programs, and other programs and field services.

As many of you probably are aware, we at AARP play an active role in congressional debates over the Federal budgets and over health and retirement income measures and tax reform. However, our legislative expenses, which include many nonlobbying activities, are less than 5 percent of our budget. Our publications and programming provide the membership and general public with a wealth of information tailored to the interests and concerns of older persons, including finance, health, pensions, travel, nutrition, and current affairs.

In addition to the news bulletin and Modern Maturity, which has the third largest circulation in the country, we distribute many other educational publications, including 8 million brochures in 1986 alone dealing with numerous topics such as Medicare's PPS system. We maintain a wide variety of national programs to educate and counsel older Americans with particular problems and needs.

Examples: Our widowed persons service provides counseling for some 35,000 persons annually who have recently lost their spouses. Our crime prevention program provides information and training to law enforcement agencies in understanding and dealing effectively with older persons. The health advocacy service program provides information to consumers and health providers concerning, health maintenance for the elderly, Medicare and Medicaid, and effective doctor/patient communications. These are a few examples of our programs.

These costs, as you can imagine, or these programs, rather, are costly. But the budgetary numbers do not show or reflect that also we have 350,000 volunteers that constitute AARP's leadership and our lifeblood for carrying out many of these programs. These volunteers are involved, for example, in the tax aid program, in the 55 alive—mature driving program, which helps older Americans improve their driving skills.

So, in conclusion, Mr. Chairman, our members look upon us as a resource in meeting the problems and the questions and the opportunities that come with age. Through its network of volunteers and paid staff, AARP devotes its resources to a wide variety of educational and social welfare programs. We urge that the subcommittee carefully weigh the impact of its decision on these programs; and, further, that it take no action that would impair AARP's ability to perform its social service function.

We would be pleased to cooperate with the subcommittee further regarding this important subject, and I thank you very much, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Brickfield.

[The statement of Mr. Brickfield follows:]

Statement of Cyril F. Brickfield, Executive Director,
American Association of Retired Persons (AARP)

Chairman Pickle, members of the subcommittee and ladies and gentlemen, my name is Cyril F. Brickfield. I am Executive Director of the American Association of Retired Persons ("AARP") with its national headquarters at 1909 K Street, N.W., Washington, D.C. I was invited here today to describe for the subcommittee the manner in which AARP, the nation's largest organized group of older Americans, fulfills the social welfare and educational functions which are the basis of its tax exempt status under Section 501(c)(4) of the Internal Revenue Code. In addition, I will outline for this subcommittee the sources of income to AARP; that income which is tax exempt and that income which is subject to the Unrelated Business Income Tax. AARP's financial statements are certified by the independent public accounting firm of Price Waterhouse, and are published annually in the AARP News Bulletin which is circulated to all 25,000,000 of AARP's members. Copies of the 1986 financial statements have been made available to the subcommittee.

By way of background, the American Association of Retired Persons was organized in 1958, primarily through the efforts of Dr. Ethel Percy Andrus, a retired high school principal. In 1947, Dr. Andrus founded the National Retired Teachers Association ("NRTA"), a California nonprofit corporation created to help alleviate, through educational and other programs, the general problems faced by retired teachers, such as inadequate teacher pensions, difficulty in obtaining health insurance, as well as the loss of self-esteem experienced by older people whom society at that time tended to ignore as having outlived their usefulness. In 1958, Dr. Andrus and other NRTA leaders formed AARP to meet the needs of those who were not eligible for membership in NRTA. In 1982, NRTA was merged into AARP.

With the watch words "to serve, not to be served," AARP was organized to meet four express purposes:

1. to enhance the quality of life for older persons;
2. to promote independence, dignity and purpose for older persons;
3. to lead in determining the role and place of older persons in society;
4. to improve the image of aging.

AARP offers to its members a myriad of benefits including educational programs, representation of the interests and concerns of older Americans before legislative, administrative, and where appropriate, judicial, bodies at the national, state and local levels, informative publications, opportunities for volunteer service as well as special member services and discounts all designed to meet the needs of mature Americans--working, retired or planning for retirement.

Membership in AARP is open to anyone age 50 and over who pays the annual dues of $5 per year or $12 for three years. Dues have been kept nominal in recognition of the fact that many older persons live on modest fixed incomes. It was Dr. Andrus' belief, and continues to be a fundamental commitment of AARP, that membership should be accessible to any interested person who qualifies by age alone.

In 1964, AARP received a determination letter from the Internal Revenue Service concluding that AARP was organized and operated exclusively for the promotion of social welfare, and accordingly, was exempt from income tax. At that time, AARP had approximately 500,000 members in 42 states and the District of Columbia, and more than 250 local chapters. Today, with over 25,000,000 members, a core leadership group of in excess of 350,000 volunteers nationwide, and a staff of over 1,200 people, AARP is the largest private nonprofit, nonpartisan membership organization in the world. It has 3,600 chapters in all 50 states, the District of Columbia and Puerto Rico, most of which meet monthly. The chapters present programs, conduct community service and educational projects, and keep members abreast of legislative and public policy issues of concern to older Americans. These chapters, are an integral part of the national organization, and operate in accordance with policies and procedures established by the AARP Board of Directors.

Volunteer Leadership

AARP is led by a unique volunteer leadership structure consisting of many groups each involved in a distinct and important activity. It is the volunteers who make program and policy decisions as members of the national board of directors, national advisory committees and legislative council, as area and state leaders and as chapter leaders. These volunteer leaders serve at every level and without compensation. Every two years, AARP holds a national convention. There, delegates elect the national officers and board of directors. The elected and appointed volunteers--some 6,000 men and women, enable AARP to work towards accomplishing its goals in every state. The volunteer structure includes:

1. the National Board of Directors, the major policy making body which is made up of the elected directors plus the national officers;

2. the National Legislative Council which meets annually to develop AARP's federal and state legislative priorities. After adoption by the Board of Directors the priorities guide the work of volunteers and staff over the next year.

3. National Advisory Committees, including standing, ad hoc and convention committees which provide broad based volunteer input for AARP programs, policies and service activities.

4. Area Vice Presidents and Associate Area Vice Presidents; State Directors, Assistant State Directors, State Coordinators; Chapter Presidents; Program Volunteer leaders; and members of State Legislative Committees.

Special Initiatives

Of particular importance to AARP's mission today are four special action initiatives: the health care campaign, the worker equity initiative, the minority affairs initiative and the women's initiative. A new effort, called "New Roles in Society", was begun in 1986 to look at social trends and the extended life cycle, and consider ways that older persons can continue to contribute to the changing world.

"Cut The Cost, Keep The Care" is the slogan of the major campaign launched in 1984 to address the increasing problems facing the nation's entire health care system. Its goals are to:
(i) Reduce the rate of escalation of health care costs;
(ii) Assure that access to quality care is maintained, and that older persons are informed of their rights under new health care systems; (iii) Preserve and strengthen the Medicare and Medicaid programs and assure the availability of affordable health care for all citizens; (iv) encourage the development of such alternative health delivery systems as health maintenance organizations, home health and ambulatory care services; (v) encourage Americans of all ages to adopt and practice more healthful life styles;
(vi) provide information to consumers on health care costs and options; and (vii) develop cooperative relationships with health care providers in order to improve health services.

The Worker Equity Initiative seeks to expand work options for men and women age 50 and older. Our volunteers and staff strive to change workplace attitudes, policies and practices that result in unequal treatment of older workers. They work with employers to develop new approaches and innovative programs, to educate workers to their rights under age discrimination laws, to advocate those rights at the local, state and national levels, and to provide preretirement planning programs and information to individuals to help them make informed decisions.

The Women's Initiative endeavors to strengthen and enlarge the leadership roles held by women, to address the special health, financial and social needs of mid-life and older women, to create additional opportunities for women to realize their full potential, and to focus attention on the contributions women are making to society.

Similarly, the Minority Affairs Initiative creates greater awareness of the special needs and conditions faced by older minority persons, through issue-oriented advocacy.

The "New Roles in Society" project will bring together some of the nation's top experts on the economy, the work place, consumerism, health care and other public policy issues to help identify priorities for the future and to help society deal with the implications of the growing numbers of older people in relation to our population as a whole, and the lengthening life span.

National Programs

AARP's national programs include:

1. Tax Aide: The Tax Aide Program, is AARP's largest volunteer program with more than 25,000 volunteers, staffing more than 8,100 counseling sites nationwide. The program provides effective and free tax counseling to more than 1,250,000 persons filing federal, state and local tax returns, most of whom are low-income elderly. The volunteers have been trained in cooperation with the Internal Revenue Service which provided funds in 1986 in the amount of $1.9 million in support of the program, which is offered in 23 languages including signing for the deaf. President Reagan awarded the nation's highest honor for Private Sector Initiatives to the Tax Aide Program at a ceremony in the White House Rose Garden in 1986.

2. Widowed Persons Service: Each year more than 900,000 American men and women lose a spouse. The Widowed Persons Service helps newly widowed men and women to cope with their loss through one-on-one support from people who themselves have gone through bereavement. More than 185 Widowed Persons Service programs are operating throughout the country. Counselors provide outreach to some 35,000 newly bereaved persons annually, provide telephone referral and hold meetings where widowed persons can share experiences or concerns on being alone.

3. 55 Alive - Mature Driving is the nation's first driver retraining program designed to meet the needs of older motorists. Established in 1967 and substantially updated in 1979, this driver improvement program has achieved national recognition by helping older persons improve their driving skills and prevent traffic accidents through defensive driving techniques. More than 165,000 older persons graduated from the program in 1986 alone. The program is conducted by thousands of volunteers nationwide who are trained from curriculum developed, tested and implemented by AARP. Graduates of the program receive auto insurance discounts from several leading companies; in 22 states such discounts are mandatory for all companies.

4. Health Advocacy Services: This educational program promotes healthy life styles and the development of new health care options, and provides information to consumers and health-providers. A health education course that helps older people become active participants in their health care has been developed in cooperation with Dartmouth University and the American Red Cross. Audio-visual programs are made available to AARP chapters,

retired teachers units and community groups, on such subjects as cardiovascular health, proper exercise and nutrition, proper use of medications, and health maintenance organizations. Volunteers initiate educational seminars on various topics such as Medicare/Medicaid promotion and effective doctor-patient communication; they conduct health services surveys, distribute physician assignment rate lists and counsel individuals about Medicare and Medicaid claims. A Medicare hotline providing free information over the telephone has been tested, as will be a protective care service hotline providing free information and referrals for those in need of protective care arrangements.

5. Consumer Affairs: The Consumer Affairs Program makes information available to help older consumers sort through today's complex financial, housing, energy, communications and shopping marketplace. Audio-visual programs are available free of charge on insurance, consumer rights, funeral planning and financial planning.

6. Housing: Because housing is a vital concern to older persons, AARP's housing coordinators advocate appropriate, affordable housing and living arrangements for older Americans. Through the publication of fact sheets, guides and booklets and the use of trained volunteers, the Consumer Housing Information Service for Seniors helps to educate older persons about housing options available to them including elder cottage housing opportunity, accessory apartments, shared housing, congregate housing and others.

7. Energy: A new consumer affairs energy program participates in utility rate-setting sessions at the state level to ensure the consideration of the effect of utility rate hikes on older persons living on fixed incomes.

8. Crime Prevention: AARP established a Crime Prevention program in 1972 and has become a recognized expert on the crime-related problems of older persons. Its Criminal Justice Services program now serves as an authoritative source of information for law enforcement agencies, federal, state and local governments and colleges and universities. A national symposium on Violent Crime Against the Elderly at the FBI Academy was co-sponsored by AARP. AARP works with law enforcement agencies to help train law enforcement officers to understand and more effectively deal with older persons and advocates for older persons volunteering in law enforcement agencies. In addition, AARP staff and volunteers train older persons in tactical crime analysis and provide police agencies with volunteer services. They develop strategies on subjects such as elder abuse, protective services planning, mediation and dispute resolution locally, and crime prevention and security in long term care settings.

9. Social Outreach Programs: AARP's social outreach and support programs, in addition to Widowed Persons Services, include the Reminiscence Program which sponsors volunteer visits to isolated elderly who are homebound or confined to a long term care or retirement facility. The AARP Interreligious Liaison provides assistance to churches, synagogues and ecumenical and interfaith agencies to develop programs that involve older persons in congregational and community service. Religious faith is the cornerstone in the lives of many older persons and AARP works to acquaint religious leaders with its many community service resources to aid religious organizations in implementing innovative volunteer programs that better serve their community and meet the needs of older persons.

10. The Senior Community Service Employment Program has been operated for 18 years by AARP with funding from the U.S. Department of Labor. This year the SCSEP grant to AARP is in excess of $45,000,000. The program provides employment for economically disadvantaged persons age 55 and over. Workers are usually placed for 20 hours a week at minimum wage in a nonprofit or public service agency where they receive work experience to prepare them for permanent employment outside the program. The current enrollment is 8,000 people at 109 sites in 33 states and Puerto Rico.

11. The Senior Environmental Employment Program, created in 1976, brings retirees with professional backgrounds back to work on short-term assignments for the Environmental Protection Agency. Positions are part-time and full-time and range from clerical to highly technical. Currently almost 350 individuals work at EPA headquarters in Washington or at the 10 EPA regional offices.

Educational Programs

In addition to these and other national programs designed to deliver services and information to AARP members and older Americans through networks of volunteers and audio/visual and written materials prepared by AARP staff, AARP plays a significant national educational role.

1. The Public Policy Institute is AARP's thinktank. It provides analysis of new developments in aging policy, reviews bills pending before Congress, drafts model state legislative statutes, and produces informative issue briefs useful to AARP volunteers in their advocacy efforts at the state and federal levels. Among the research activities of the Public Policy Institute in 1986 were: (i) studies on the impact of the various tax reform proposals on older Americans and the impact of pension provisions included in the Senate Reform package; (ii) analysis of the impact of the proposed federal budget and the Gramm-Rudman-Hollings legislation on older individuals and on programs serving the older population; (iii) study of home health-care benefits under Medicare; (iv) comprehensive analysis of issues surrounding the crisis in medical malpractice and product liability insurance coverage; (v) study of the impact on company retirees whose firms modify or terminate their existing pension plans to recapture "excess assets"; (vi) ongoing review of proposals for catastrophic health insurance coverage; and (vii) analysis of the financial status of older women living alone, the extent to which they lack health insurance and the role of Medicare in financing health care for older women.

2. AARP employs its research and data-gathering resources to identify needed public information gaps and to speak with greater authority on aging policy concerns. For instance, in 1986 AARP conducted surveys of the employees of various companies to determine the level and type of care-giving activities provided by workers to aging parents, spouses and other relatives; it sponsored a survey of Americans of all ages regarding intergenerational issues and attitudes towards other age groups; it assessed health expenditures in the last year of life and the implications of such outlays for public policy; and it prepared a survey on state activities in nursing home accreditation.

3. The National Gerontology Research Center maintains an on-line computer data base on aging, entitled AgeLine, and makes available technical research and information assistance to the gerontological community, federal agencies and the public through this data base, as well as its collection of 18,000 volumes. More than 2,500 users across the U.S. and Canada have access to AgeLine.

4. AARP's Institute of Lifetime Learning serves as a national clearing house for the academic community, government agencies and other organizations interested in developing educational services for older people. It produces resource material describing college centers for older learners, learning opportunities for older persons, and how to help make America literate.

5. AARP's Voter Education Program is designed to educate the electorate about issues of importance to older persons, but will not support or oppose candidates for office or contribute to election campaigns.

6. The AARP Andrus Foundation, created as a memorial to AARP founder Dr. Ethel Percy Andrus, awards grants to universities for research in gerontology and for applied research action projects. At the annual meeting of the Association of Gerontology and Higher Education in 1986, the AARP Andrus Foundation was accorded special recognition. A plenary session was entitled, "Recognition of AARP Andrus Foundation's Contributions to Higher Education."

7. AARP's Legal Counsel for the Elderly ("LCE") program has provided training in 1986 to 636 lawyers, paralegals and other advocates in the substantive law and advocacy skills necessary for representing low-income older persons. LCE recruited over 650 AARP members to serve as volunteers in 10 advocacy projects throughout the country. So far, 136 of these volunteers serve as intake workers, consumer advocates, nursing home ombudsmen and paralegals. Technical assistance in the effective use of volunteers was provided to 16 legal service agencies. The legal hotline in Pittsburgh, Pennsylvania provided free legal advice and brief services to nearly 5,000 older persons. This model project successfully tested a new low-cost way of providing prompt legal services to a large number of older persons. LCE's representative payee project provides volunteers to assist older people to manage their financial affairs when friends and relatives are not available to help. Eleven new projects averaging 39 volunteers each were established in the past year.

On the local level, LCE provides legal services to nearly 2,000 older residents of the District of Columbia. The assistance offered by LCE yielded nearly $1,000,000 in benefits for largely low-income clients in 1986 alone. In addition, LCE serves as the long term care ombudsman for the District of Columbia. Training was given to over 60 volunteers who visit every nursing home in the District of Columbia and have investigated and resolved about 300 complaints of older nursing home residents in D.C. LCE continues to serve as the District's legal services developer, providing coordination of the activities of other advocacy programs and the private bar in serving older D.C. residents.

International Programs

Internationally, AARP played a leadership role in establishing the International Federation on Ageing ("IFA") in 1973. The IFA is a nongovernment, nonpolitical and nonprofit educational and social welfare organization which seeks to provide a world-wide forum for the discussion of problems of aging and retirement. A total of 97 organizations in 48 countries are currently members of IFA. Under the auspices of AARP, Ageing International, an informational bulletin on the field of aging world-wide, is published. IFA has consultative status with the Economic and Social Council of the United Nations. AARP was an active participant in the United Nations Conference on the Future of Aging and at the meeting of the World Health Organization in Geneva.

Publications and Programming

AARP seeks to educate and inform its membership and other older Americans through a wide variety of regular publications and programming, as well as through special brochures on topics of concern to older persons.

1. Modern Maturity is AARP's bimonthly magazine providing members with a wealth of information and entertainment tailored to their interests and concerns. It includes articles on finance, pensions, second careers, retirement locations, travel, personalities, food, health and current affairs. Given the size of AARP's membership base, Modern Maturity currently has the third largest circulation in the country.

2. To provide its members with a more frequent source of news and features, AARP publishes a monthly News Bulletin which reports to members on public policy developments affecting their lives. The Bulletin keeps members informed about AARP's programs and on news of AARP's legislative efforts.

3. AARP publishes a bimonthly newsletter with a circulation of 280,000 entitled Highlights which provides AARP volunteers and community agencies with useful information about program resources, aging issues and service opportunities. It reports on volunteer, chapter and Retired Teachers Association unit activities.

4. Newsletters, which are regularly published by most of AARP's program offices, range from Worker Equity issues to Tax-Aide updates to information needed by Medicare assistance volunteers. For example, a bi-monthly newsletter from the Worker Equity Initiative entitled Working Age provides information about older employees and related work issues to 15,000 corporate officials and policymakers.

5. Underwritten as a public service by AARP, Modern Maturity Television, a magazine-style television series features personality profiles and topics of interest to older persons. It is aired on over 250 stations within the Public Broadcast Service network nationwide.

6. Prime Time, the radio series sponsored by AARP, is broadcast each week by more than 300 radio stations. Having begun its thirteenth season, it is the longest running public affairs series in radio history. The program now includes a "News From AARP" segment which describes new programs, booklets and other information available from AARP. The programs deal with retirement and preretirement subjects, also in an informative magazine-style format.

7. In 1986 about 8 million brochures were requested by and distributed to interested older persons, members and nonmembers. For example, Knowing Your Rights, a guide to Medicare's prospective payment system, has been distributed to more than 2,000,000 interested individuals at a rate of 50,000 per week. Other brochures are described in All About AARP which has been made available to the subcommittee.

8. The Association's vast array of audio/visual and slide/tape programs are available on loan to AARP chapters and other community groups and provide an excellent source of educational information. For example, video tapes on issues of interest to older consumers were provided to 180 talk show hosts and 700 news directors.

Legislative Advocacy

As members of Congress you are probably aware of the role that AARP plays in Congressional debates over the federal budget, health and retirement income measures, as well as tax reform. During 1986, AARP worked toward the achievement of some notable enhancements in current government programs and policies and to initiate new efforts benefiting older persons. Among the federal legislative advocacy activities were: (i) major tax reform legislation, removing 750,000 low-income older persons from the tax rolls and providing for an extra standard deduction to protect low and moderate income tax payers; (ii) inclusion of major pension reform provisions in the tax reform bill which will lower pension vesting from 10 to 5 years; (iii) limit the amount individuals can lose through Social Security/pension integration and improved pension coverage for lower wage workers; (iv) federal legislation abolishing mandatory retirement and extending the protections of the Age Discrimination in Employment Act to workers 70 years and older; (v) legislation requiring employers to continue to credit the pension benefits for those employees who work beyond the age of 65; (vi) expansion of Medicaid to include more low-income older persons, improving their access to health care; (vii) enactment of the Medicare Quality Protection Act to provide better access to post-acute-care and an expanded role for peer review organizations to ensure quality care and better program coordination; (viii) creation of the Physician Payment Review Commission and representation by AARP on that body; (ix) participation in the food stamp information project designed to address under-utilization of that program by older persons despite exceptionally high rates of elderly malnutrition; (x) continued efforts on the Congressional front and through comments to the Federal Communications Commission to ensure low-income elderly consumers basic, affordable lifeline telephone service; and (xi) development of federal legislation protecting the rights of nursing home patients.

On the state level AARP worked toward the passage of more than 350 bills addressing major issues of concern to older residents in the areas of health care, housing, consumer protection and discrimination.

This concludes a broad, but by no means exhaustive, overview of those national, international and local educational, community service and legislative activities that AARP conducts in furtherance of its social welfare purposes. In addition to such programs, AARP offers services to its members, also in fulfillment of its social welfare functions, which generate income.

Sources of Revenue

Aside from the grant funds mentioned earlier which are dedicated to specific uses, AARP derives support from four principal sources. These are, in order of magnitude, membership dues, administrative allowances derived in connection with the group health insurance program, investment income and advertising income.

Dues: Membership dues are the largest source of revenue for AARP. A major portion of these dues is used to produce the educational publications described previously. Membership dues are, of course, not taxable to AARP.

Health Insurance Program Income: AARP's group health insurance program is one of AARP's oldest programs, established in the 1950's. The cost of proper health care has always been an especially critical concern of older Americans.

AARP pioneered the concept of group health insurance designed for older Americans. At the time the program was instituted, there was no such insurance generally available. Insurance companies were reluctant to enter this field because of the exposure to major risks and the lack of any precedent proving the viability of such insurance on a major scale. Dr. Ethel Percy Andrus, AARP's founder, was able to get a commercial insurer to take these risks and offer such coverage, with no health questions, modest pre-existing condition limitations, and reasonable identical rates for all members, whatever their age and wherever they resided. It was found that such insurance satisfied an important need of AARP's members, and AARP thereafter has continuously arranged for group medical insurance plans for its members.

Congress in 1965 passed Medicare, and commercial insurers began to offer supplemental group health insurance to older Americans. Despite these helpful developments, the need for AARP's program still exists among older Americans. Even with improvements now being considered, Medicare is a limited program and leaves a considerable risk of financial burden on the participants. Compared to AARP's program, no other private program offers as comprehensive coverage for the cost, offers such coverage so easily to so many people in need of it, or keeps pace as well with the rapid changes in the delivery of health care services and in Medicare reimbursement policies. This is demonstrated not only by the growth of the program (currently over five million individual member insureds), but also by surveys conducted at AARP's expense by the independent consulting firm of Towers, Perrin, Forster & Crosby concerning whether and to what extent the membership of AARP wants it to continue to sponsor this program. These surveys demonstrate emphatically that AARP's sponsorship of group health insurance is still of great importance to the membership.

AARP, through a trust established for this purpose, obtains group health insurance for its members by contracts with an unrelated commercial insurance company (currently, the Prudential Insurance Company of America). AARP selected the current insurance provider in 1981 with the assistance of the Towers, Perrin firm, which invited 64 companies to participate and reviewed proposals from 16 of those companies. AARP has a contract with Prudential establishing standards for premiums, loss ratios, claims services, and the insurance company's profit (which in no event can exceed 2.25%). AARP's objective in negotiating the contract is to see that it properly meets the needs of older Americans at as reasonable a cost and as high a quality as can be obtained.

Once the contract is in place (typically for a five year term), AARP monitors the promptness and quality of the insurance company's performance, makes expense/control audits of performance (including an actuarial audit through independent experts at least annually), engages in ongoing research to determine whether new benefits or other changes in the policies are needed or desirable, and, in general, serves as an "ombudsman" to see that complaints are adequately and quickly resolved. When, for example, in 1984 and 1985, claims experience proved to be more favorable than anticipated, AARP saw to it that insured members received substantial refunds of premiums.

AARP directly and through experts it hires is constantly evaluating the intricate provisions of its health insurance policies and insisting on changes or new provisions which benefit the insured. AARP has the power and the expertise--and uses it--to be an effective bargaining agent for its members with the insurance provider. AARP has a unique position as the single most important organization that represents and protects the interests of older Americans in this field, not only in obtaining the best contracts for them but also in setting the standard that other group health insurance programs must meet.

Our members might very well be better off if we had a national health program. They certainly would benefit from more extensive and comprehensive Medicare coverage. These are areas in which AARP's legislative advocacy efforts continue apace, as you well know, even though, if Medicare were so expanded, our members would not need so much supplemental health insurance. AARP has always been, and will remain, committed to such efforts.

Thus, AARP's group health insurance program, from negotiation of the policies to monitoring its operations, directly promotes the social welfare of older Americans. AARP receives an administrative allowance, currently at approximately 4% of the premiums under the program. This is reported to AARP's entire membership in its annual reports, and to the Internal Revenue Service on AARP's annual Form 990, as income substantially related to AARP's social welfare purposes.

Investment Income: AARP's third largest source of income is interest and royalty income. Over half of this income consists of royalties received from separate taxable entities not owned or controlled by AARP that use the AARP name in offering quality goods and services to older Americans. The AARP Pharmacy Service, for example, is an affordably priced, mail-service pharmacy for older Americans which is administered by Retired Persons Services, Inc. (a fully taxable District of Columbia corporation) and its taxable subsidiaries. The pharmacy service, which has always been taxable, was created in order to fill a need of older Americans, which was then unmet and continues. Other sources of royalty income include the AARP Auto and Homeowners Insurance provided by the Hartford Insurance Company, the AARP Motoring Plan provided by Amoco Enterprises, Inc., the AARP Travel Service provided by Olson-Travelworld Ltd., the AARP Book Program of Scott, Foresman & Company, and various travel-related services provided by major hotels and car-rental companies.

AARP enters these programs only after it determines that the program will be of special value to its members, that is, that the program is consistent with AARP's social welfare purposes of benefiting older Americans. Because of the passive character of this income (royalties and interest income on investments), the income to AARP is not subject to tax under current law. Section 512(b)(1) and (2) of the Internal Revenue Code.

In the future, AARP also anticipates receiving dividend income from the AARP Financial Services Corporation, a wholly owned subsidiary of AARP formed to participate in the management of the AARP Investment Program. AARP Financial Services Corporation is a taxable for-profit corporation which, via a joint venture with Scudder, Stevens and Clark (an unrelated investment advisory firm), participates in the management of a diversified family of no-load mutual funds offered to AARP members. In the future AARP Financial Services Corporation may also participate in the management of a national credit union recently formed for AARP members, but the operation of the credit union is still in the formative stages.

Advertising Income: AARP also derives revenue from the sale of advertising in the two AARP periodicals distributed to the entire membership, Modern Maturity and the AARP News Bulletin. Such revenue is treated as taxable unrelated business income in AARP's annual federal income tax return, Form 990-T. Nevertheless, AARP has to date not incurred actual tax liability with respect to this income because, under the applicable regulations and rulings, such liability does not arise where the organization's total periodical costs exceed its total periodical income. This has been AARP's situation since it first accepted advertising in its publications in 1980.

Conclusion

AARP's diverse membership has many interests and needs, and the Association has succeeded in responding to this diversity. Our members look upon AARP as a resource in meeting the problems, questions and opportunities that come with age. Through its paid staff and network of volunteers, AARP devotes its resources to a wide variety of educational and social welfare programs aimed at accomplishing the four purposes expressed in its charter. AARP urges that the subcommittee carefully weigh the impact on such programs in making its decisions, and that it take no action that would impair AARP's ability to perform its social welfare function.

Chairman PICKLE. Mr. Geer, you have not made your statement yet, have you?

Mr. GEER. No, I haven't.

Chairman PICKLE. We would be pleased to recognize you.

STATEMENT OF RODERICK L. GEER, EXECUTIVE VICE PRESIDENT, MILLION DOLLAR ROUND TABLE, DES PLAINES, IL, AND VICE CHAIRMAN OF THE BOARD, AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

Mr. GEER. Mr. Chairman, thank you very much.

I am Roderick Geer, excutive vice president of the Million Dollar Round Table, located in Des Plaines, Ill. The roundtable is a not-for-profit, individual membership organization of approximately 20,000 of the top life insurance salesmen who meet rigid production and professional requirements each year. And to better understand my orientation, Mr. Chairman, let me add that the roundtable is a 501(c)(6) trade association but has no unrelated business income. Our budget is 7.5 million. We do have a 501(c)(3) foundation, which is the philanthropic arm of our organization. And these two entities, within the last 2 years, have done these things: $100,000 contribution to Save the Children, for the Ethiopian Fund; $50,000 to the Dallas Public Broadcasting Station to develop a series of programs on health care and maintenance; $50,000 to the Make-A-Wish Foundation for terminally ill children, Medic-Alert, Mothers Against Drunk Driving, the Mexican Relief Fund. And I don't think our organization is particularly unique. I think there are literally hundreds, perhaps thousands, of not-for-profit trade associations and professional societies out there doing pretty much what we are doing.

I also serve, coincidentally, as vice chairman of the American Society of Association Executives, and I am appearing in their behalf today. This organization is an individual membership society representing 14,000 executives who manage nearly 7,000 trade associations and professional societies. It was founded in 1920 with just 67 members. Today, it is an organization with an overall constituency of 80 million individuals and companies belonging to these trade associations and societies.

I am here today with Robert S. Haynes, who serves on ASAE's board of directors and chairs its finance and administration, and two members of our staff who have been extremely helpful to me, Lisa Myers, who is director of member services, and Malcolm Carl, our director of finance.

ASAE serves three primary purposes. We seek to enhance the professionalism of our association executive members to improve the performance of the voluntary membership organization they represent and to assist these executives and their organizations in dealing effectively with public policy issues that serve the broad needs of society.

ASAE welcomes the subcommittee's review of unrelated business income tax statutes. We recognize that a comprehensive review hasn't been accomplished since 1969 and since that time not-for-profit organizations have turned increasingly to nondues sources of income to carry out their tax-exempt mission. Nondues does not necessarily mean unrelated business income.

Now along the way management techniques have improved and a great number of products and services are now available to nonprofit organization members and the general public alike. In the wake of these developments some small businesses have complained that the not-for-profit groups are exploiting an unfair competitive advantage. ASAE respectfully disagrees with that assertion. We believe not-for-profit organizations have been accorded tax-exempt status in recognition of their valuable role in society. The vast majority of trade and professional societies continue to fulfill this public policy mandate.

Inappropriate and unnecessary changes to the UBIT statute would profoundly affect the way all the associations operate. Therefore, ASAE supports preservation of the existing statute along with strict IRS enforcement of the current rules.

Now, Mr. Chairman, we further believe that reliable information in the tax-exempt sector is essential before any changes in UBIT can reasonably be considered. Tax-exempt organizations are an extremely diverse lot. We know that good public policy depends on having accurate information; consequently, a broad-brush tax law change based on false perceptions could be damaging. And we have taken the trouble to extract from a yet-to-be published study some data that I think will be of interest to you, Mr. Chairman, and members of the committee. It is a preliminary data from a policies and procedures study for 1987. Here are some quick facts from it, and we can supply more if they will be helpful to you.

Item: 21 percent of the average income from unrelated business sources is 21 percent average, but the median, Mr. Chairman, is only 10 percent. And that tells us something very significant. It tells us that there are very few associations that are heavily engaged in unrelated business activity, but, by and large, trade associations and professional societies are not heavily engaged.

Item: We know that ASAE membership is roughly divided two-thirds 501(c)(6) trade associations, one-third 501(c)(3) associations.

Item: We know that only 19 percent of ASAE members have established a for-profit subsidiary, mostly State and local and regional, not so many nationals, and that surprised even me. This contrasts with 30 percent of these members who have formed their own foundations, mostly charitable and research. Thirty percent in the foundation field; only 19 percent active in the unrelated business area with subsidiaries.

We know that the primary activities of these subsidiaries are group insurance, publishing, and to a lesser degree, data processing—all of which are very logical extensions of service expectations members have of their trade and professional societies.

ASAE has several recommendations for ensuring that tax-exempt organizations understand and comply with the UBIT statute. These suggestions underscore the need for accurate data on the tax-exempt community which would serve as a factual basis for evaluating UBIT in all respects. We recommend the following:

First, the Internal Revenue Service should strictly enforce current UBIT rules. Nonprofit organizations that abuse their tax-exempt status should be dealt with in a swift and efficient manner.

Second, the IRS should provide more assessable information in the form of published revenue rulings.

Third, representatives of the tax-exempt community should work closely with the IRS to revise the 990 and 990–T forms.

Fourth, the IRS and tax-exempt organizations should cooperate on a project to gather reliable, long-term data on the nonprofit sector. We don't feel it truly exists yet.

Fifth, leaders of the not-for-profit and small business communities should continue the dialog they have begun designed to clarify the competition issues and establish appropriate ways of addressing them.

To summarize, we support preservation of UBIT in its current form. In our estimation, anecdotal evidence does not constitute a valid basis for evaluating tax-exempt organization policy or considering specific changes in UBIT. While it is apparent that tax-exempt organizations have expanded their income-producing activities in recent years, this does not mean that such activities are unrelated to their exempt purposes. On the contrary, ASAE sees the vast majority as continuing to serve public benefit.

Thank you very much, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Geer.

[Mr. Geer submitted the following statements:]

STATEMENT OF RODERICK L. GEER, CAE
EXECUTIVE VICE PRESIDENT, MILLION DOLLAR ROUND TABLE
AND VICE CHAIRMAN,
AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES
BEFORE THE HOUSE WAYS AND MEAN SUBCOMMITTEE ON OVERSIGHT
HEARING ON THE UNRELATED BUSINESS INCOME TAX

JUNE 29, 1987

Mr. Chairman and Distinguished Members of the Committee:

I am Roderick Geer, Executive Vice President of the Million Dollar Round Table, located in Des Plaines, Illinois. The Round Table is a not-for-profit individual membership organization of over 20,000 life insurance agents who sell more than $3.5 million of new life insurance annually.

I also serve as Vice Chairman of the American Society of Association Executives, based in Washington, D.C. This organization, known as ASAE, is an individual membership society representing 14,000 executives who manage nearly 7,000 trade and professional associations in the United States and abroad. ASAE was founded in 1920 with just 67 charter members. Today, the organization has an overall constituency of more than 80 million individuals and companies belonging to trade associations and professional societies worldwide.

I am here today with Robert S. Hanes, who serves on ASAE's Board of Directors and also chairs its Finance and Administration Section.

ASAE serves three primary purposes. We seek to enhance the professionalism of our association executive members; to improve the performance of the voluntary membership organizations they represent; and to assist these executives and their organizations in dealing effectively with public policy issues that serve the broad needs of society.

Mr. Chairman, the American Society Association Executives welcomes your Subcommittee's review of the unrelated business income tax statute. ASAE recognizes that a comprehensive review is justified, inasmuch as Congress last surveyed the topic in 1969. Since that time, not-for-profit organizations have turned increasingly to non-dues sources of income to carry out their tax-exempt mission. Along the way, management techniques have improved, and a greater number of products and services are now available to nonprofit organization members and the general public alike. In the wake of these developments, some small businesses have complained that not-for-profit groups are exploiting an unfair competitive advantage.

ASAE respectfully disagrees with such assertions. We believe not-for-profit organizations have been accorded tax-exempt status in recognition of the valuable role they play in society. The vast majority of trade and professional association activities continue to fulfill this public policy mandate and are justifiably tax-exempt. Inappropriate and unnecessary changes in the UBIT statute would profoundly affect the way all associations operate. Therefore, ASAE supports preservation of the existing statute, along with strict IRS enforcement of the current rules. We also recommend a stepped-up effort to understand the tax-exempt sector of our economy, as well as an IRS commitment to foster greater awareness of the rules governing UBIT. Such measures, we believe, would significantly enhance the tax-exempt community's understanding of this statute, making compliance much less problematic.

Mr. Chairman, we further believe that reliable information on the tax-exempt sector is essential before any changes in UBIT can reasonably be considered. Tax-exempt organizations are an extremely diverse lot. We know that good public policy depends on having accurate information. Consequently, any "broad-brush" tax law changes, based upon false perceptions of the not-for-profit sector, could be very damaging. Tax exempt organizations have always been adaptable, and they might have to respond to UBIT changes by cutting back member services. This would have far-reaching consequences, since the government would almost surely need to "fill the gap" of services now provided by nonprofits. Ultimately, the American taxpayer would be called on to foot the bill for any additional government outlays.

ASAE has several recommendations for ensuring that tax-exempt organizations understand and comply with the UBIT statute. These suggestions underscore the need for accurate data on the tax-exempt community, which would serve as a factual basis for evaluating UBIT in all respects. We recommend the following:

1) The Internal Revenue Service should strictly enforce current UBIT rules. Nonprofit organizations that abuse their tax-exempt status should be dealt with in a swift and efficient manner.
2) The IRS should provide more accessible information in the form of published revenue rulings, regulations, and official publications, in order to increase organizations' understanding of the UBIT rules. This might include a compendium of activities where the tax is generally understood to apply.
3) Representatives of the tax-exempt community should work closely with the IRS to revise Forms 990 and 990-T.
4) The IRS and tax-exempt organizations should cooperate on a project to gather reliable, long-term data on the nonprofit sector.
5) Leaders of the not-for-profit and small business communities should continue a dialogue designed to clarify the competition issue and establish appropriate ways of addressing it.

To summarize, ASAE supports preservation of the UBIT statute in its current form. In our estimation, anecdotal evidence does not constitute a valid basis for evaluating tax-exempt organization policy or considering specific changes in UBIT. While it is apparent that tax-exempt organizations have expanded their income-producing activities in recent years, this does not mean that such activities are unrelated to their esempt purpose. On the contrary, ASAE sees the vast majority as continuing to serve the public benefit, regardless of whether they compete with a taxable business.

Mr. Chairman, I thank you for the opportunity to testify on this subject.

STATEMENT OF JOHN V. JOHNSON, CAE
EXECUTIVE VICE PRESIDENT, AMERICAN COLLECTORS ASSOCIATION
AND CHAIRMAN OF THE BOARD,
AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES
SUBMITTED TO THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT,
HEARINGS ON THE UNRELATED BUSINESS INCOME TAX
JUNE 22, 1987

Mr. Chairman and Distinguished Members of the Committee:

I am John V. Johnson, Executive Vice President of the American Collectors Association (ACA) located in Minneapolis, Minnesota. ACA is a not-for-profit trade association with more than 3,300 corporate clients who provide debt collection service for approximately 800,000 credit-granters in the United States and abroad.

I also serve as Chairman of the Board of the American Society of Association Executives, based in Washington, D.C. This organization, known as ASAE, is an individual membership society representing 14,000 executives who manage nearly 7,000 trade and professional associations in the United States and abroad. ASAE was founded in 1920 with just 67 charter members. Today, the organization has an overall constituency of more than 80 million individuals and companies belonging to trade associations and professional societies worldwide.

ASAE serves three primary purposes. We seek to enhance the professionalism of our association executive members; improve the performance of the voluntary membership organizations they represent; and assist these executives and organizations in dealing effectively with public policy issues that serve the broad needs of society.

Mr. Chairman, the American Society of Association Executives welcomes your Subcommittee's review of the unrelated business income tax statute. ASAE recognizes that a comprehensive review is justified, inasmuch as Congress last surveyed the topic in 1969. Since that time, Americans have elected three presidents, concluded one war, been through several national traumas, embraced computer technology, and made a host of lifestyle changes. Nonprofit organizations have also changed with the times, turning more to non-dues sources of income to carry out their tax-exempt mission. Concurrently, management techniques have improved, and a greater number of products and services are now available to nonprofit organization members and the general public alike. In the wake of these developments, some small businesses have complained that nonprofits are exploiting an unfair competitive advantage.

ASAE respectfully disagrees with such assertions. We believe that nonprofit organizations have been accorded tax-exempt status in recognition of the valuable role they play in society. The vast majority of trade and professional association activities continue to fulfill this public policy mandate and are justifiably tax-exempt. Inappropriate and unnecessary changes in the UBIT statute would profoundly affect the way all associations operate. Therefore, ASAE supports preservation of the existing statute, along with strict IRS enforcement of the current rules. We also recommend a stepped-up effort to understand the tax-exempt sector of our economy as well as an IRS commitment to foster greater awareness of the rules governing UBIT. Such measures, we believe, would significantly enhance the tax-exempt community's understanding of this intricate statute, making compliance much less problematic.

Mr. Chairman, throughout my testimony I will be referring to "tax-exempt organizations," "nonprofit organizations," and "associations." At this point, I should like to clarify the meaning of the term "nonprofit" with respect to these groups. A "nonprofit" entity is one granted tax-exempt status under Section 501(c) of the Internal Revenue Code. This designation reflects that the group primary exists to serve the needs and interests of its members or the general public. In this way, it differs from a commercial business, which operates primarily for profit. However, the term "nonprofit" can be misleading, since it implies that tax- exempt organizations need to stay in the black to provide member services, finance their physical operations, and plan for the future. Thus, when I refer to "nonprofit organizaitons" or "nonprofits," please do not infer that these groups realize no net income. In fact, as I shall explain, such a definition no longer fits the modern tax-exempt organization.

The American Society of Association Executives is presenting this testimony in order to assist the Oversight Subcommittee with its wide-ranging UBIT review. Mr. Chairman, we appreciate the Subcommittee's diligent inquiry into this area, and wish to furnish the most relevant information possible. In that spirit, I shall now discuss the unrelated business income tax statute: its purpose, development, and application over the years.

Congress enacted the UBIT statute in 1950 mainly to address concerns over "unfair competition" - that is, the perception that some nonprofit groups were establishing for-profit operations in direct competition with taxable businesses. UBIT was incorporated into the Internal Revenue Code of 1954, and expanded to cover all tax-exempt organizations in 1969.

UBIT requires an organization to pay tax on the net gain from activities that are considered unrelated to its tax-exempt purpose. Specifically, "unrelated business income" is defined as the income from any unrelated trade or business regularly carried on by the exempt group. A "trade or business" is an activity conducted for the production of income through the sale of goods or the production of services. Whether the profit -making activity takes place in a larger context of exempt activities makes no difference. Nor does the end result - i.e. whether the activity is actually profitable. As long as profit is intended, then a trade or business is considered to be involved. This means that the activity need not impinge on a taxable business to be subject to UBIT.

A second determinant of "unrelated business income" is whether the business activity is regularly carried on; that is, conducted frequently or continuously in a way comparable to that of a commercial organization. A third factor - and by far the most difficult to judge - is whether the business activity is substantially related to the association's exempt purpose. In order to qualify as "substantially related," an activity must contribute importantly to the association's purpose and be aimed at a goal other than simply realizing income. Under this criterion, UBIT would not apply to any activity substantially related to that organization's tax-exempt purpose, even if it competed with a taxable business.

The UBIT statute lists several instances where the tax does not apply. Five major exclusions have been enacted over the years:

- Investment earnings (so-called "passive income") including rents, royalties, interest, dividends, and gains from capital property (unless such income is received from holdings the exempt organization acquired by borrowing funds);

- Income derived from research performed for federal, state, or local governments; research performed by a college, university, or hospital; and basic (as opposed to applied) research;

- Net income from qualified trade shows held in connection with association meetings and conventions;

- Income derived from activities conducted "primarily for the convenience of members, students, patients, officers, or employees" of a charitable, religious, scientific, literacy, or educational organization tax-exempt under Internal Revenue

Code Section 501(c)(3); and

- Income from the sale of merchandise donated to the association, or where substantially all the activity is performed by volunteers working without compensation.

The courts and the Internal Revenue Service have been interpreting and applying the UBIT statute for the past 37 years. Notwithstanding, IRS claims to have difficulty interpreting the statute, mainly due to uncertainties over the relatedness test. It is certainly true that all the facts and circumstances of a particular case (e.g. the nonprofit organization's exempt purpose, the nature of its income - producing activities, and their interrelationship in serving the organization's function) make such determinations difficult. However, association legal counsels generally agree that IRS has been effectively enforcing the statute, despite these encumbrances. Furthermore, association professionals familiar with UBIT believe that, as a matter of principle, it is fairly clear.

At the same time, the statute has been applied and interpreted through a multitude of IRS private letter rulings, General Counsel Memoranda, and other avenues with limited distribution. Consequently, the corpus of UBIT law is often less than clear to many tax-exempt organizations, their attorneys and accountants. In order to remedy this shortcoming, the American Society of Association Executives would support IRS clarification of relevant cases through more public means (such as published notices, regulations, revenue rulings, and official publications). Such an effort would undoubtedly raise the tax-exempt community's understanding of UBIT, furthering compliance as a result.

One further point, Mr. Chairman, seems appropriate in this context. Some IRS officials have indicated that a lack of well-trained personnel hampers the administration of UBIT. Indeed, the Service appears to assign relatively low priority to cases involving this statute. Furthermore, IRS employees with responsibility in this area have generally gained their expertise on the job, since tax-exempt organization law is not a specialty offered by many law schools. Seen in relief against other IRS activities, it is clear the UBIT statute could be better enforced. One noteworthy development in this regard is the formation of an exempt organizations advisory group, which will assist the IRS Commissioner on a wide range of problems and issues. ASAE commends the Treasury Department on this initiative, and looks forward to working closely with IRS on similar ventures designed to clarify tax-exempt organization matters.

Mr. Chairman, ASAE understands that your distinguished Subcommittee intends to develop a profile of tax-exempt organizations and their income-producing activities, in connection with its UBIT review. We are very pleased to assist in this undertaking by providing data relevant to the association community.

As you know, the tax-exempt sector encompasses a remarkably diverse array of organizations, interests, services, and activities. Section 501(c) of the Internal Revenue Code lists 25 tax-exempt categories and over 260 examples of exempt organization activities (U.S. General Accounting Office: Tax Policy: Competition Between Taxable Businesses and Tax-Exempt Organizations, February 1987, p.14). The former include section 501(c)(3) religious, educational, and scientific groups; 501(c)(4) civic leagues and social welfare organizations; 501(c)(5) labor unions; and 501(c)(6) trade associations and business leagues. The 501(c)(3) groups predominate, comprising 43 percent of all tax-exempt organizations. Section 501(c)(5) and (c)(6) groups make up another 15 percent of the community. This proportion is reversed among ASAE's membership. Approximately two-thirds of our members represent (c)(5) and (c)(6) groups, and about a third represent (c)(3)'s.

Remarkably, there are no precise figures on the number of nonprofit organizations nationwide. The IRS estimates over 800,000 organizations, double its estimate of 25 years ago (U.S. General Accounting Office, p. 14). IRS data are quite limited in this regard, since numerous tax-exempt groups are not required to file returns (including churches, private nonprofit hospitals, universities, and organizations with under $10,000 in annual gross income). Indeed, only 328,000 informational tax forms were filed by tax-exempt organizations as of five years ago (U.S. Small Business Administration: Statistical Profile of the Nonprofit Sector, April 1985, p.2).. Still, some private sector estimates put the number of nonprofits at over a million (U.S. General Accounting Office, p.12).

The matter of these organizations' annual income is also unresolved. The Commerce Department estimates a total of $131 billion, or 3.3 percent of GNP (U.S. General Accounting Office, p. 15). However, other guesses put the figure much higher (U.S. Small Business Administration, p.2). Whatever the actual amount, it appears that a few large organizations account for much of this income. A study of tax-exempt organization data from 1975 determined that 501 (c)(3) groups accounted for over half of the sector's total revenue (U.S. General Accounting Office, p.15). Within this category, health care organizations and educational institutions controlled 36 and 17 percent, respectively. Of particular interest is the finding that, while just 1 percent of tax-exempt groups reported annual revenues of $10 million or more, these accounted for 60 percent of the sector's total income.

Another valid question concerns nonprofits' sources of income. Apart from membership dues, revenue is derived from a variety of areas: contributions; grants; educational programs; interest and dividends; royalties and sales of assets. Tax-exempt organizations appear to be realizing more income overall, much of it from non-dues sources. For example, ASAE's 1985-86 Association Operating Ratio Report tracked over $1.4 billion in revenue reported by the 600 associations surveyed, a 37 percent increase over five years. Over half that total was non-dues income. Conventions and expositions accounted for over 14 percent, easily the largest source in the non-dues category. IRS figures, which may or may not be accurate, show that tax- exempt organizations reported an aggregate $114.6 billion in 1975, of which member dues made up just 17 percent (U.S. General Accounting Office, p.17). In contrast, 18 percent came from contributions and grants, and 39 percent from "business receipts" (excluding interest, dividends, rents, royalties, and sales of assets). Interestingly, a somewhat different ratio was reported for trade and professional associations -- the majority of groups represented by ASAE members. Here, 54 percent of income came from dues, 5 percent from contributions, and 18 percent from "business receipts." In any case, nonprofits clearly rely on an abundance of revenue sources.

In the end, not too much is certain about the tax-exempt sector. We can say that it is extremely diverse, both in number of organizations and types of activities. It is dominated by Section 501(c)(3) groups, with a small number of large entities accounting for the majority of its revenue. Although organizations raise revenue in a variety of ways, non-dues income has become increasingly important. All things considered, however, the tax exempt community's 3 percent share of GNP is still rather small.

Undeniably, much better information is needed on the nonprofit sector. The only official repository of relevant data - the IRS - concedes that its statistics may not accurately reflect the type, nature, and extent of nonprofits' income-producing activities (U.S. General Accounting Office, p.12). To its credit, the IRS has moved swiftly to fill this information gap. On the one hand, it is attempting to ensure greater accuracy when Form 990 data are initially recorded. Second, the Service plans to work with private sector groups in developing a better survey of tax-exempt organization activities. And third, IRS will be auditing a random sample of 990-T forms, examing them for unrelated business taxable income.

Mr. Chairman, The American Society of Association Executives believes that more reliable information on the tax-exempt community is essential before any changes in the UBIT statute can reasonably be considered. Tax exempt organizations, not to mention trade and professional associations, are an extremely diverse lot. We know that good public policy depends, to a large degree, upon complete and accurate information. Consequently, any "broad-brush" tax law changes, based upon false perceptions of the nonprofit sector, could be very damaging.

Tax-exempt organizations have always been adaptable, and they might have to respond to UBIT changes by cutting back member services. This would have far-reaching consequences, since the government would almost surely need to "fill the gap" of services now provided by nonprofits. Ultimately, the American taxpayer would be called on to foot the bill for any additional government outlays.

Instead, ASAE recommends that the Internal Revenue Service and representatives from tax-exempt organizations work together to revise Forms 990 and 990-T. (The former requires general information on nonprofits' sources of revenue; the latter must be filed by nonprofits with more than $1,000 in annual gross unrelated business income.) Such a project could, if carried to fruition, provide the IRS with better data on tax-exempt organization activities, as well as make compliance with the law substantially easier. ASAE also recommends that the IRS work with representatives of the nonprofit sector to collect reliable, long-range data on the sector's size, rate of growth, and sources of income. Through such a composite picture, lawmakers and the general public would have a better understanding of the nature and role of tax-exempt organizations, without the myriad questions that now obscure fundamental points.

Mr. Chairman, I stated at the outset that tax-exempt organizations have changed with the times. I should now like to address two key questions: What are these changes, and why have they taken place? More importantly, are nonprofit groups still in keeping with their tax-exempt purpose?

Tax-exempt organizations' main sources of income have traditionally been membership dues, contributions, and passive investments. However, these have often proved inadequate to meet members' needs. Tax exempt status means that associations cannot raise capital by issuing stock. Nor can they take advantage of options available to taxable businesses: small business set-asides, loan guarantees, management assistance, tax credits and deductions, depreciation allowances, etc. In order to raise the necessary funds, therefore, many groups have turned to other activities for which they charge fees. These include: meetings and seminars; trade shows; periodicals, books and studies; and group insurance programs. Income from these activities in turn helps further the tax-exempt purpose of the organization. In addition, some nonprofits attempt to build a reserve of funds for future growth, as well as for their survival during economic downturns.

The trend toward non-dues income has developed for several reasons. First, many nonprofits have experienced a decline in government grants. Second, the level of private financial support can be irregular and unreliable. Third, income-producing activities are an effective means of gaining revenue to cross-subsidize an organization's activities.

Today, traditional concepts regarding nonprofit organizations are changing. The basic term "nonprofit," for example, is undergoing a re-evaluation. Are income producing nonprofits "nonprofit"? Or are they "commercial" in the same sense as a taxable business? The answer in both cases is plainly "no". Today's nonprofit organization is often a hybrid, carrying out its exempt purpose both innovatively and professionally. Perhaps the best description of modern tax-exempt groups is "not-for profit." That is, they do not operate principally to realize income, but do produce revenue through both dues and non-dues sources. In the overwhelming majority of cases, such activities contribute importantly to an exempt purpose, serving members' needs as well as the general public.

At the same time, the courts and IRS have in many instances concluded that certain activities ought to be subject to unrelated business income tax. These include: advertising in association publications; group insurance programs; job placement services; and the sale of mailing lists. Therefore, through judicial interpretation and IRS enforcement, nonprofit organizations now pay tax on these activities.

In light of the way that tax-exempt groups have evolved, the distinguished Members of the Subcommittee have indicated an interest in examining claims of "unfair competition." Specifically, some segments of the small business community allege that nonprofit organizations are engaged in commercial ventures unrelated or only tangentially related to their tax exempt purpose, in direct competition with taxable business.

Various organizations, including the Small Business Administration, have alleged that a host of tax-exempt organization activities are unfairly competitive, including: fitness centers, day care facilities, nursing homes, hearing aid and prescription drug sales, hospital services, university book stores and printing operations, data processing, computer sales, research and development, travel and tour services, laboratory testing, audiovisual services, and consulting. Among the most frequently cited cases are universities, research centers, and hospitals (U.S. Small Business Administration: Unfair Competition By Nonprofit Organizations with Small Business: An Issue for the 1980's, Novermber 1983).

Given so many alleged instances of unfair competition, it seems appropriate to ask where small business representatives do not see the problem occurring. In fact, ASAE posed that question three years ago and the reply was, "associations themselves are perceived to represent an insignificant portion of the problem" (ASAE press release, November 6, 1984). Perceptions, however, are not the same as documentation. In fact, there is little evidence to show that nonprofit organization activities are unfairly competitive. It is obvious that basic tax-exempt activities (such as research centers, hospitals, and nursing homes) often involve sales of products and services to the public in competition with for-profit businesses. However, these are clearly related to a tax- exempt purpose and provide an unmistakable public benefit. In fact, some have argued that commercial businesses are moving into areas traditionally overseen by nonprofits.

Overall, little information is available to document claims of "unfair competition." The General Accounting Office recently concluded that "complete data do not exist to quantify the nature, extent, and impact" of the perceived problem (U.S. General Accounting Office, p.1).

In such a statistical vacuum, ASAE believes that anecdotal evidence does not constitute a valid basis for evaluating tax-exempt organization policy or considering specific changes in the UBIT statute. While it is apparent that tax-exempt organizations have expanded their income-producing activities in recent years, this does not mean that such activities are unrelated to their tax-exempt purpose. On the contrary, ASAE believes that the vast majority continue to serve the public benefit, regardless of whether they compete with a taxable business.

Despite certain question marks and ambiguities that remain after 37 years of judicial interpretation and IRS enforcement, ASAE believes that the statutory definition of "unrelated business income" is well worth keeping. ASAE does not believe that competition between nonprofit and for-profit groups should be a factor in the UBIT equation. Congress, after all, developed the statute specifically to prevent nonprofits from competing unfairly with taxable businesses. UBIT was not intended to affect an organization's exempt status, nor to discourage nonprofit groups from carrying out related activities -- regardless of their competitive nature. Statutory changes would penalize all nonprofits, instead of the few engaged in activities clearly peripheral to their tax-exempt purpose. ASAE believes that such cases are few and far between, and supports preservation of the

UBIT statute in its current form.

Mr. Chairman, the American Society of Association Executives has several recommendations for ensuring that tax-exempt organizations understand and comply with the unrelated business income tax statute. These suggestions underscore the need for complete and accurate data on the tax exempt community, which would serve as a factual basis for evaluating UBIT in all respects. We recommend the following:

1) The Internal Revenue Service should strictly enforce current UBIT rules. Nonprofit organizaitons that abuse their tax-exempt status should be dealt with in a swift and efficient manner.

2) The IRS should provide more accessible information in the form of published revenue rulings, regulations, and official publications, in order to increase organizations' understanding of the UBIT rules. This might include a compendium of generally accepted activities where the tax applies.

3) Representatives of the tax-exempt community should work closely with the IRS to revise Forms 990 and 990-T.

4) The IRS and tax-exempt organizations should cooperate on a project to gather reliable, long-term data on the nonprofit sector.

5) Leaders of the nonprofit and small business communities should continue a dialogue designed to clarify the competition issue and establish appropriate ways of addressing it.

ASAE appreciates the Oversight Subcommittee's diligent review of the unrelated business income tax statute. We offer our resources and those of our members in helping to clarify the appropriate tax treatment of nonprofit organizations. Mr. Chairman, I thank you and the members of your Subcommittee for the opportunity to testify on this subject.

Chairman PICKLE. This is a very good panel. We are glad you would come and testify, for this will be helpful to us.

Mr. Grosvenor, I have some questions to ask you, but I want to say to you that I am a member of the U.S. Capitol Historical Society and I am on the executive committee, and we are very grateful for the help that the National Geographic gave to the society years ago to get it underway. You kind of gave us seed money and put us into business, and we are now a very strong organization, we think. So I just simply want to publicly say once more that we appreciate the National Geographic.

Now having said that, let me get into some other business here. Is your society, that is, the National Geographic Society, engaged in any commercial activities now in furtherance of your tax-exempt purpose? Are you involved in any commercial activities?

Mr. GROSVENOR. No activities other than what I stated in my written statement and the one I delivered today.

Chairman PICKLE. Well, I noticed that you have listed with us a list of exempt operations.

Mr. GROSVENOR. Correct.

Chairman PICKLE. And that includes memberships, dues, books, children's books, World Children magazine, Travelers magazine, cartographic products, calendars, video cassettes, and so forth. That is a total of $13 million of tax-exempt operations. As I understood your statement, the only part that you pay UBIT on is the sale of advertising space, which is less than 10 percent of your whole operation.

Mr. GROSVENOR. That is correct, sir.

Chairman PICKLE. So all these above are activities that you and presumably the IRS said are nonprofit; that is they are related and wouldn't be subject to the tax.

Mr. GROSVENOR. It is my understanding that those are all related activities under the present law; yes, sir.

Chairman PICKLE. Well, that is a lot of volume and a lot of expenditures. I just wonder where would you draw the line. I notice that the National Geographic now has some specials on the television network. I have seen at least one advertisement on a local station. I think you also sell some videos.

Now do you have arrangements with a TV station or with these stores that actually sell these things? Do you furnish them for free, or do you sell them?

Mr. GROSVENOR. No, sir. We produce the product. We place the specials on PBS, and on the Explorer—from our cable division—on WTBS and we also provide the video cassettes for Vestron. Our sole participation is to produce the product, and they sell it. We have no partnership with them.

Chairman PICKLE. Do you make that available to them for no cost?

Mr. GROSVENOR. No, sir. Well, PBS, we make it available at no cost; yes, sir. But as to the cable, we are paid to produce that material, and in the case of the video tape——

Chairman PICKLE. I want to be sure I understand you. When you give that tape to Channel 5 here, we will say, you do not charge them for that tape?

Mr. **Grosvenor**. If it is PBS, they are given it free. If it is a commercial channel such as Channel 5, they pay us for that tape.

Chairman **Pickle**. I see.

Mr. **Flippo**. Would the distinguished chairman yield?

Chairman **Pickle**. Yes, sir.

Mr. **Flippo**. I think right on this point, does the society market its scientific or educational materials, books or maps, with anyone other than its members?

Mr. **Grosvenor**. Sir, we offer them by direct mail only to our members. There is one very small exception to that. In our own headquarters we have a very small gift shop that actually operates at minus net dollars. But our business is done with direct mail to our members in the United States and Canada.

Mr. **Flippo**. Thank you.

Chairman **Pickle**. Well, I thank you, Mr. Grosvenor.

Now, Mr. Geer has given me a lot of recommendations here, in about five or six categories. I read them to indicate generally that you don't think we need changes in the law, but rather we need stronger enforcement of the laws we have. Am I correctly interpreting your recommendations?

Mr. **Geer**. That is correct.

Chairman **Pickle**. You are just asking for more data and stronger enforcement?

Mr. **Geer**. There is a shortage of viable data right now. ASAE is attempting to collect that data which might relate to our constituency, but there are many other constituencies on whom the data is probably weak.

Chairman **Pickle**. Well, do your organizations as a whole throughout the United States, do they pay UBIT?

Mr. **Geer**. Yes.

Chairman **Pickle**. I beg you pardon?

Mr. **Geer**. Yes.

Chairman **Pickle**. How much?

Mr. **Geer**. It works out, based on some data that Lisa Myers was kind enough to develop for me this morning, the average national income of the associations tested in our operations ratios report for this year is 3.9 million, of which 14 percent is unrelated business income, or 490,000. They pay, on an average, $38,700 in taxes. And therein lies a concern, Mr. Chairman. The inference clearly is that not-for-profits pay no taxes. In fact, I think universally the legitimate enterprises are stepping up and paying their fair share of taxes on unrelated business activities.

Chairman **Pickle**. Your statement is that, by and large, you do pay the UBIT?

Mr. **Geer**. Absolutely.

Chairman **Pickle**. Well now, Mr. Brickfield?

Mr. **Brickfield**. Yes, sir.

Chairman **Pickle**. I noticed here that you have listed your sources of income.

Mr. **Brickfield**. Yes, sir.

Chairman **Pickle**. I don't know whether it is the third or the fourth, but in one category you state that one of your largest sources of income is interest and royalties income.

Mr. **Brickfield**. Yes.

Chairman PICKLE. And that one-half of this income consists of royalties received from separate taxable entities. Some of the entities that you have provide: pharmaceutical services, auto and homeowners insurance, an AARP motoring plan, an AARP travel service, a book program, and various travel-related programs.

Now all of these are exempt and not subject to the UBIT. Do you know the volume that is involved—you say the source of income. How much income is involved in this?

Mr. BRICKFIELD. Just a moment, Mr. Chairman; $20 million in royalty income, Mr. Chairman.

Chairman PICKLE. $20 million. And what was your third largest source of income, just before that?

Mr. BRICKFIELD. U.S. Government grants.

Chairman PICKLE. I beg your pardon?

Mr. BRICKFIELD. We receive grants from the U.S. Government, Mr. Chairman.

Chairman PICKLE. All right.

Mr. BRICKFIELD. And the third largest source of income was from these Government grants, and they amounted to $46 million.

I might point out that this is pretty much a pass-through operation. If you look at our financial statement, you will see $46 million in revenue and $46 million in expenses, which pays the compensation as salary of economically disadvantaged older people who are seeking to be retrained.

Chairman PICKLE. Well, in each one of these categories, whether it is pharmacy, auto motoring plan, book program, and so forth, and briefly can you tell me what services they render people? Obviously, the pharmacy, you sell them medicine?

Mr. BRICKFIELD. Well, we first decide, Mr. Chairman whether there is a need, a great need out there. Like in the pharmacy service which you mentioned, we know that the elderly, especially those on Medicare, that prescription drugs are not covered by Medicare, by and large they are not, and yet it is a tremendous area of their expenses. Prescription drugs is a very high cost item. So having established a need that the elderly need these prescription drugs, we could then go out to commercial enterprises, which pay taxes, and ask them if they would provide this kind of service to our membership. Generally this is a passive kind of income. What we do is first decide whether there is a need, then we impose standards and set up monitoring compliances. From there on in such organizations, whether it be homeowners insurance or auto insurance or pharmacy services, render these services to our membership.

Chairman PICKLE. Give me an example. You establish a need and you want to furnish medicine for your Medicare members.

Mr. BRICKFIELD. Yes.

Chairman PICKLE. And you employ or you select a national concern, a for-profit organization?

Mr. BRICKFIELD. Yes, sir.

Chairman PICKLE. And do you say to them, if you furnish medicine at a certain price, we will pay for it? Or how do you do it?

Mr. BRICKFIELD. No, no. We say to them, will you provide prescription drugs, say, at competitive or affordable prices.

Chairman PICKLE. All right.

Mr. **Brickfield**. To supply drugs and prescriptions to our membership. Thereafter we perform an oversight or monitoring function.

Chairman **Pickle**. Well, you will say to that company will you furnish prescription drugs at a certain price?

Mr. **Brickfield**. No, they set the price, Mr. Chairman, and they are the ones that are competing with other pharmaceutical companies in the marketplace, so they must be competitive. What we do is we perform a function of oversight to make certain that our people in our judgment are receiving pharmaceuticals at fair and reasonable prices.

Chairman **Pickle**. All right. You have made your investigation and you have made your determination that pharmaceutical company A is a good company and would sell their product at a competitive price.

Mr. **Brickfield**. Yes.

Chairman **Pickle**. Now what do you do, list that firm in your publications?

Mr. **Brickfield**. Yes. We list that firm as an endorsed service provider. We endorse that firm's services.

Chairman **Pickle**. All right. Now, if you endorse that firm, and you don't sell any medicine but that information is passed on to your membership—that here is company A that can sell to you—we have ascertained that they are selling at competitive prices.

Mr. **Brickfield**. Yes, sir.

Chairman **Pickle**. And they are on the approved list. Do you receive any royalty or income from that?

Mr. **Brickfield**. Yes, we do.

Chairman **Pickle**. I see. And that is passive and therefore is not counted as income?

Mr. **Brickfield**. That is right. Under the present law; yes, sir.

Chairman **Pickle**. And essentially, these other programs work in the same manner?

Mr. **Brickfield**. Pretty much the same way, Mr. Chairman. Yes.

Chairman **Pickle**. Well. Do these various companies that you have listed, like the pharmacy, do they receive any funding from you?

Mr. **Brickfield**. No, sir. They receive no funding, but, we do sometimes provide advertising discounts when they advertise in our periodicals, and we do this usually during what we call a development period. When we get a new service coming on line, we give them——

Chairman **Pickle**. Regarding these companies that I have mentioned, the pharmacy, automobile motoring plan, and so forth—who owns and operates them?

Mr. **Brickfield**. Well, for example, the Hartford Insurance Co. is a for-profit stock company. It has stockholders and it is a subsidiary of the International Telephone & Telegraph Corp.

Chairman **Pickle**. Well does AARP have a minority ownership in any of them?

Mr. **Brickfield**. No. We have no relationship other than a contract arrangement with Hartford Insurance Co.

Mr. **Thomas**. Let me pursue that line of questioning. Private sector activities, whether it be pharmaceuticals, insurance, travel service, what have you—you basically sell your name to them so that they can say that they are an AARP——

Mr. **Brickfield**. Provider.

Mr. **Thomas** [continuing]. Provided group, or endorsed, or, what is it that you are selling?

Mr. **Brickfield**. Endorsed service. It is an endorsed service of ours, Mr. Thomas, and they provide services to our membership.

Mr. **Thomas**. They get a discount, perhaps, in advertising in your publications?

Mr. **Brickfield**. Yes, sir, for certain limited periods of time, usually during development periods. Yes, sir.

Mr. **Thomas**. Are they limited to using the AARP name in association with their products only to your members?

Mr. **Brickfield**. That is right, sir. They can market only to our membership, using our name.

Mr. **Thomas**. So they cannot run an ad in Newsweek or Time saying it was AARP-endorsed?

Mr. **Brickfield**. No, sir. If they run an ad in a newspaper to the outside world, we prohibit them putting in that advertising, that "we are also a provider of AARP". That is right.

Mr. **Thomas**. How do you folks in these various services get together? Do you go out, and you solicit? Do you have competitive bidding as to which is the insurance company that gets your name?

Mr. **Brickfield**. Yes, sir. What we do, once we have determined that there is this need, either in the pharmacy service or in automobile or health-care services, we go out and we solicit organizations on a competitive-bid basis. We request proposals be submitted to us.

We set the standards. If it is health insurance or auto insurance, we determine the basic provisions of the policy, and then we ask for the submission of bids.

Mr. **Thomas**. Has anyone ever come to you with the idea that this would be something that would be good in that area, rather than you solicit them?

Mr. **Brickfield**. Well, yes, oftentimes suggestions are made. I think it is somewhat akin to a Member of Congress receiving suggestions from his or her own constituency.

They are looked at and they are examined, and——

Mr. **Thomas**. I do not think it is akin to that. I think your analogy is a poor one, but go ahead.

Mr. **Brickfield**. Well, nonetheless, we then go out, and through focus groups, or through surveys, or through various methods of canvassing the membership, having received a suggestion we determine whether or not there is first this need, and then after——

Mr. **Thomas**. Do you have a contract period for this? I mean, is there a——

Mr. **Brickfield**. Pardon, sir?

Mr. **Thomas**. A contract period that you enter into this marketing relationship?

Mr. **Brickfield**. Yes. Depending upon the services, and what the practice is in the commercial industry, why, we would enter into contract agreements, and many of them run 5 years. Some run 7 years with renewable provisions and, also, if a party wishes to terminate, I think there is a 6 months termination clause in them.

Mr. **THOMAS**. In your testimony, you indicated that your publications began advertising in 1980.

Mr. **BRICKFIELD**. That is about it. That is right.

Mr. **THOMAS**. What was the rationale for accepting advertising, and why did you not have it prior to that?

Mr. **BRICKFIELD**. Well, in 1980, as always, we were looking for meeting members needs. When we went into advertising, there were surveys which indicated that our members who read our magazines and periodicals like to see advertising. They have been weaned on seeing advertisements in magazines. And so, for that reason, and perhaps others that do not readily come to mind, we decided to test advertising in our periodicals, and since there was a need for it among our membership, and on that basis we decided on advertising for our publications.

Mr. **THOMAS**. Are your periodicals sold only on subscription, or do they appear on newsstands?

Mr. **BRICKFIELD**. No, they are not sold at all, Mr. Chairman. Our two large periodicals are a part of the membership function, and if you are a member——

Mr. **THOMAS**. So that is why you have never shown a profit. You give them away.

Mr. **BRICKFIELD**. Well, I do not want to say that. A member pays $5 dues, and as part of the dues the member receives the publications. And I might say our publication is the one effective way of communicating with some 25 million members.

Mr. **THOMAS**. Thank you. Mr. Grosvenor, in terms of your magazine, is it sold only by membership, or do you——

Mr. **GROSVENOR**. Membership, sir. Only by membership.

Mr. **THOMAS**. Only by membership, which includes the magazine. You have a pretty good mailing list, I would assume, in terms of membership. Do you engage in any sales of the mailing list?

Mr. **GROSVENOR**. No, sir. No, sir. We have never sold our mailing list.

Mr. **BRICKFIELD**. If I might interject, Mr. Thomas, neither does AARP.

Mr. **THOMAS**. Well, I sometimes wonder about that. You mentioned politics and Congress, but, I guess there are different ways of getting those lists.

Mr. **BRICKFIELD**. No, I——

Mr. **THOMAS**. I am just teasing, Mr. Brickfield. Just teasing.

Mr. **BRICKFIELD**. No, I do not want that statement to go by, Mr. Chairman. No one. Believe me, we do not sell and we pepper our lists and——

Mr. **THOMAS**. We all salt them, I know, and somehow, they still get out.

You have got quite an operation Mr. Grosvenor in terms of publication. All of us have admired, for years, the quality of the printing. Is that done outside? Inside?

Mr. **GROSVENOR**. The printing is done outside, sir. Several commercial printers. The magazine is printed down in Corinth, Miss. by the W.F. Hall Co. The books are printed, and atlases, by several different printers, all commercial.

Mr. THOMAS. Development of the photography, and the rest of it, all outside?

Mr. GROSVENOR. Much of the photography is done inside. We have staff photographers. We also have contract photographers, free-lance photographers. They all contribute to the editorial content.

Mr. THOMAS. What about text and printing? That is all done——

Mr. GROSVENOR. The same thing as——

Mr. THOMAS. Composition is done internally?

Mr. GROSVENOR. Composition is done internally. Yes, sir.

Mr. THOMAS. Word processors, I assume?

Mr. GROSVENOR. Yes, sir.

Mr. THOMAS. You have got buildings, facilities to do this in?

Mr. GROSVENOR. We do, indeed, in Washington, DC.

Mr. THOMAS. How were these paid for?

Mr. GROSVENOR. They are paid for. Yes, sir.

Mr. THOMAS. The buildings, how were they paid for?

Mr. GROSVENOR. The buildings, sir, were paid for in cash. We have a fairly old-fashioned philosophy at the National Geographic Society. We do not go into a building program, or we do not purchase equipment or computers until we have the money.

And sometimes it has taken us 30 to 40 years to get the money, but we do that. We do not believe in deficit financing.

Mr. THOMAS. Inside buildup is a little easier when you do not have to pay taxes?

Mr. GROSVENOR. Well, we have been in business a long time, and we have been able to accumulate that money. But actually, sir, it is in the long run a lot less expensive for us to build our own buildings. Before we built the last one we were told that it would cost us about $7 million to rent comparable space, and we could make that up over 5 or 6 years and come out ahead in the long run.

Mr. THOMAS. In looking at your sheet, in terms of exempt and the unrelated business activities, you do not net much on your advertising.

Mr. GROSVENOR. No, sir.

Mr. THOMAS. Less than one-tenth of 1 percent.

Mr. GROSVENOR. That is not intentional, sir. We just are not driven by——

Mr. THOMAS. That was my next question. Is it worth it?

Mr. GROSVENOR. As I am sitting here today, I wonder that myself.

Mr. THOMAS. Have you always had advertising in the magazine?

Mr. GROSVENOR. We have had advertising for the last 50 to 60 years, yes, sir, but we have very strict restrictions on advertising. We are accused by the advertising industry of banking ads. That is, that we put advertisements in the front and back of the magazine, and we do not put it, commingle it with the text. We do not take alcohol. We do not take tobacco. We do not take firearms. We do not take some kinds of ads.

And we also have a very strict policy about positioning that we——

Mr. THOMAS. Have you always had ads on your back page?

Mr. **Grosvenor**. Yes, sir, from the very first time we took advertising, we had it on the back page. For years it was the Coca-Cola Co., back in the 1930's and 1940's.

Mr. **Thomas**. The Santa Clauses. Yes.

Mr. **Grosvenor**. Right.

Mr. **Thomas**. I always wanted that $200 lifetime subscription but we were never able to afford it, and I think it went off the front pages a few years ago.

In your text, on page 10, you were talking about some studies you are doing with teaching geography.

Mr. **Grosvenor**. Yes, sir.

Mr. **Thomas**. The poor quality of education going on, and, you are talking about providing some materials. Are those video? Are they textbook, lesson plan materials? What is it that you are providing in these pilot programs for teaching geography?

Mr. **Grosvenor**. They are a combination of programs, sir, and a combination of products. We have one in two particular schools, one in Alice Deal here in the District of Columbia, and one in Audubon which is in Los Angeles. It is an inner city public school, a very fine school. We have a pilot program to try to determine how to more effectively teach geography in the school systems.

We hope that the experience from that pilot project will lead us to a more productive long-term program to spread geography education throughout the United States.

Mr. **Thomas**. Might that lead you into textbook production?

Mr. **Grosvenor**. We have looked at textbooks in the past, sir, but we have felt that they were satisfactorily covered by the commercial sector, so we have not entered it.

However, it is clear that in today's world, where our kids are visually oriented, that textbooks are not really meeting the demand of kids today. So I would not be surprised to see, in the future, a more visually oriented textbook. Maybe a laser video disk, maybe a cassette, a CD of some kind.

The clearly traditional textbooks are not meeting the requirements of geography today. Our students rank in the Third World in their knowledge of geography, and this is very disturbing to us.

Mr. **Thomas**. Yes. I know. What advantage has the tax-exempt status provided your organization?

Mr. **Grosvenor**. Well, I think that if you look at our financial sheet, you will see that, basically, the bottom line is that in 1986 we had $13 million of income after all of our operations and our grants, and our various expenses. So we were able to use that money for research, exploration. We put more than 50 percent of our net income back into either the scientific community or the educational sector.

It has allowed us to more productively pursue the increase and diffusion of geographic knowledge across a very broad spectrum.

Mr. **Thomas**. The previous panel testified—Ms. Reed, as a matter of fact used a phrase which I think we will find useful, and that is the halo effect. Almost like blue sky.

Do you believe that there was any significant advantage to your ability to promote your organization as a tax-free entity early on, or even recently, which would give you not a bottom accounting sheet advantage, but a halo effect in terms of the activities that you are engaged in?

Mr. GROSVENOR. Well, I suppose if you are perceived as an organization of excellence, and I think we are in our field, we do have a halo. I do not think there is any argument about that.

I would like to point out, however, that we were founded in 1888, which was 6 years before any thoughts of income tax——

Mr. THOMAS. Federal income tax, yes.

Mr. GROSVENOR. So that had nothing to do with the founding.

Mr. THOMAS. I understand.

Mr. GROSVENOR. It has taken us a century to build that halo. You cannot say, for certain, whether that halo is for being nonprofit, but I like to think it is because our members trust us. We have an 86 percent renewal rate which is very high by any standards of measurement of acceptance. So we feel the halo is based on trust, past experience, from what our members have learned of us.

Mr. THOMAS. Could you carry on your basic mission if you were not tax exempt?

Mr. GROSVENOR. Sir, our mission would remain the same. I am confident that we would carry on. We would change our way of doing business.

Right now, we do not offer our low-priced books, atlases, or globes in bookstores. I think that part would change. I have to believe that our image would be hampered, somewhat, by not having the not-for-profit status, the educational status that we now enjoy, but I think image would be our most important concern if we became a commercial entity. That is short-term sir.

Long-term, I am not sure it is possible for a CEO of a profit-making company to really ignore profit and the bottom line as a primary motive of his business.

We honestly do not do that at the National Geographic Society, but if we were a business entity—I would hope it would not happen in my day—but I would suspect it would creep into the organization, the temptation to maximize profits rather than to increase and diffuse geographic knowledge, and I think that would be too bad.

Mr. THOMAS. Let me just say that a cursory examination of your facilities, and the product, and other factors on your sheet, would indicate that even though you are not for-profit you are doing very well, and those who are motivated along that line would be very envious of your operation because I think you do it well.

Mr. Geer, just very briefly, in terms of the indication of the things that you want enforced strictly, and the rest of it—do you think there is any merit to providing some kind of a procedure to call to the IRS's attention practices that are going on, at least for review purposes? Some kind of a feedback within the IRS structure, so that people who could file complaints, either anonymously or otherwise, to focus attention on activities?

Mr. GEER. That procedure should be in place through your 990 and 990-T information forms, but if it is not, it ought to be.

Mr. THOMAS. Well, I think more elaborately, where someone could identify specific——

Mr. GEER. More elaborate forms, and we have volunteered, of course to assist the IRS and Treasury in redesigning that form.

Mr. **Thomas**. So you would have no problem, if we were looking at ways in which individual taxpayers, or for-profit operations could provide specific examples to IRS for follow-up purposes?

Mr. **Geer**. We have no problem with disclosure.

Mr. **Thomas**. Thank you very much.

Chairman **Pickle**. Mr. Flippo.

Mr. **Flippo**. Thank you, Mr. Chairman. I just have a couple of brief points I wanted to make.

First of all, Mr. Grosvenor, I was impressed with the fact that—I believe you said that 59 percent of these revenues, or your business activity, you contracted to the private sector?

Mr. **Grosvenor**. That is correct, sir.

Mr. **Flippo**. Do you receive any dividends from those individuals?

Mr. **Grosvenor**. From those transactions?

Mr. **Flippo**. Yes.

Mr. **Grosvenor**. No, sir.

Mr. **Flippo**. Any royalties?

Mr. **Grosvenor**. No, sir.

Mr. **Flippo**. You are creating a lot of business for small business, in that sense, then, I suppose, are you not?

Mr. **Grosvenor**. Well, we like to think we are. Yes, sir.

Mr. **Flippo**. Let me ask you, Mr. Brickfield, in your activities here, Mr. Pickle asked if you had any minority interest in any of the firms with which you do business.

Let me ask you this. I think the AARP Financial Services Corp. is a taxable for-profit corporation, which has entered into a joint venture with an unrelated investment advisory firm to provide no-load mutual funds to AARP members.

Mr. **Brickfield**. Yes.

Mr. **Flippo**. Are these services offered by this corporation associated, or are they related to the exempt purposes of the AARP?

Mr. **Brickfield**. Yes. Well, I would like to submit a statement for the record on that, Mr. Flippo, which would elaborate on that.

[The following was subsequently received:]

The AARP Investment Program provided by the investment firm of Scudder, Stevens & Clark offers a diversified family of no-load mutual funds including a money fund investing in government backed securities, as well as six funds designed for members seeking income, tax free income or growth. The majority of older people need to maximize income from their fixed resources. Assisting older persons in accomplishing this end is consistent with AARP's mission as expressed in its charter. After conducting surveys designed to assess member needs, the Investment Program was created to help members deal with their finances effectively and conveniently in light of the confusing array of financial options being promoted today.

AARP Financial Services Corp. is a partner with Scudder, Stevens & Clark in AARP/Scudder Financial Management Company, which is the investment advisor to the funds offered through the Investment Program. Because of the extent of the activity of AARP Financial Services Corporation in the operation and administration of the Investment Program, AARP Financial Services Corp. was created as a commercial stock corporation, whose income will be subject to tax at ordinary corporate rates. Any income paid to AARP by AARP Financial Services Corp. would be paid as a dividend from after tax income. Such dividends would be nontaxable to AARP under Section 512(b) (1) and (2) of the Internal Revenue Code as amended.

Mr. **Brickfield**. But briefly, we have AARP Financial Services Corp., and that corporation enters into an agreement, or agreements with, say, investor organizations. And both AARP Financial, and the investor groups, they both would pay taxes. But as I understand it, that while the Financial Corp. is separate and apart from AARP itself, it is nonetheless dedicated to see that invester groups serve the AARP membership well.

Mr. FLIPPO. Yes. Now what I am interested in trying to determine is whether or not the AARP receives dividends from these taxable corporations?

Mr. BRICKFIELD. As I understand it, AARP has not yet received any dividends or royalties—I believe that is the proper word from AARP Financial Services Corp.

Mr. FLIPPO. Are you entitled to receive any from——

Mr. BRICKFIELD. We will, one day, hopefully, receive that, yes.

Mr. FLIPPO. Should you receive any dividends, would they be subject to the unrelated business income tax

Mr. BRICKFIELD. I think they would be considered under the provisions of the IRS Code as nontaxable to AARP.

Mr. FLIPPO. Nontaxable to AARP?

Mr. BRICKFIELD. I believe so, yes. To AARP. May I just make one other clarification, Mr. Flippo. When the chairman earlier asked about automobile insurance and pharmacy, and my answer lumped the two of them together.

The AARP Auto is underwritten by Hartford. The pharmacy service, which is called Retired Person's Pharmacy Services is a nonprofit, Mr. Chairman, which AARP created back in 1959 at the time of the Kerr-Mills legislation on Medicaid. But it is separate from AARP, separately incorporated in the District of Columbia, and while a nonprofit, it is treated as unrelated business income, and it pays income taxes.

Mr. FLIPPO. Yes, I understand that.

Mr. BRICKFIELD. Yes, sir.

Mr. FLIPPO. But the point that I am trying to make is that when these tax-paying entities pay dividends or royalties to AARP.

Mr. BRICKFIELD. Yes, sir.

Mr. FLIPPO. They are not taxable to the AARP under the present code?

Mr. BRICKFIELD. That is right.

Mr. FLIPPO. But the taxable companies do get a deduction. So even though they get a deduction from the income taxes under the Code, it is not taxable to AARP?

Mr. BRICKFIELD. I believe that is correct as to royalties, sir.

Mr. FLIPPO. So, in a way, that is a little bit of a double-whammy there, because even though they get a deduction, it is not taxable on the other side, and I just wanted to make that point.

Mr. THOMAS. Would the gentleman yield on that point very briefly.

Mr. FLIPPO. Yes. I would be delighted to.

Mr. THOMAS. In terms of your selling the AARP name to these groups on the royalty end of it, do you have a fixed flat fee for the use of the name, or do you operate on royalties from the activities generated?

Mr. BRICKFIELD. We operate on a flat royalty fee with our pharmacy service which is one percent, I believe, Mr. Thomas, of their gross sales, which amounts to about $1 or $2 million a year.

Mr. THOMAS. So it is gross sales. Is that true on the other activities—travel service, the rest?

Mr. BRICKFIELD. No.

Mr. THOMAS. Is that a fixed fee, or do you get a percentage?

Mr. BRICKFIELD. No. We generally get a percentage.

Mr. THOMAS. So all of these are a percentage of sales, and that is why you would have discounted advertising to get them started, initially, because the better they did the more you would make?

Mr. BRICKFIELD. Well, yes and no. For example, our health-care program always paid 100 percent of the advertising costs from day one, but some of the others like our travel service—you will recall about a year and a half ago, with the *Achille Lauro* incident, where they had a big setback and some 30 percent of their travel being cancelled, why, we recognized that and we have continued to give them the benefit of advertising discounts.

Mr. THOMAS. Thank you. I thank the gentleman for yielding.

Mr. FLIPPO. Well, I think the gentleman from California made a very good point, that this is not a flat fee but it is a percent of the action.

Mr. BRICKFIELD. Yes, sir. And here again, there are ceilings, so that beyond a certain point it does not go all—or in some other instances, Mr. Flippo, when it gets to be a certain amount in sales, why, the fee is reduced. Percentage of fee is reduced.

Mr. FLIPPO. Gosh, that sounds almost like profit.

Mr. BRICKFIELD. Well, these companies all pay income taxes, and as they go up in volume, while it is a percentage, we provide, for example, in health insurance, that the fee will be reduced from whatever the percentage is to a lesser percentage rate and the benefits inure not to the company or AARP but to the insureds.

Mr. FLIPPO. Thank you. Thank you very much.

Chairman PICKLE. It seems to me we have three of the largest groups in the country here today on this particular panel. A lot of revenue volume is involved here. And I am just wondering how broad it is.

Mr. Brickfield, you say your organization meets, and if you decide that you are going to give a certain service, you, or your board get together, and you determine is there a need, and then you go and provide that service one way or another, and any income you get out of it is not taxable.

Now, I notice that one of your categories you listed for me was travel services. Is there a need for travel assistance for people who have reached 50 or 55 and retired? Is that part of the purpose of your exemption?

Mr. BRICKFIELD. Yes, sir. Incidentally, I will answer that question but I would like to preface it by simply saying that whatever income we receive from royalties, or from related income, that money, Mr. Chairman, is recycled right back into meeting other programs such as widowed persons, services, and crime, so it——

Chairman PICKLE. I understand that, Mr. Brickfield, but——

Mr. BRICKFIELD. Yes. Okay.

Chairman PICKLE. That could be true of a hundred different services. So you cannot justify it on the basis you just put it back into the organization.

Mr. BRICKFIELD. Yes. Well——

Chairman PICKLE. It is unrelated activity, and you say there is a need for people to travel, and one of your precepts is to improve your image, and the health and attitude of people. They need to travel. And therefore, you have set up a travel agency, indirectly. Now is that part of a tax-exempt purpose?

Mr. **Brickfield**. Yes. Let me address that, directly.

Chairman **Pickle**. Well, if that is—well, go ahead.

Mr. **Brickfield**. In the area of travel services, we know that when people move into retirement, they have great expectations and they want to travel, and they would like to travel, but they have special needs. They do not take seven day trips to Europe trying to visit five cities. It simply cannot be done.

So we tailor our trips to meet the special needs of the elderly, which means perhaps slower trips. Instead of spending two days in a place, or a day and a half, they set it up so they spend 3 days there.

We also provide medical attention for many of our elderly travellers because some of them are or become disabled. They use or need protheses on occasion. We also provide for them—which not all services do—porter services. And then also, we try to put them into hotels which are convenient to the places to be visited.

So it does have a uniqueness about it that really is tailored to the particular needs of the elderly group which we serve.

Chairman **Pickle**. Well, there is no beginning or end to the "services" you could give. You could decide, and with all good faith, that you are going to have a book group, or any kind of a service.

And that is what has happened with this whole field. That organizations just keep expanding their services. Once IRS gives them the 501(c)(3) status, there is no end to it because the funds you get are pumped back into the total organization. And where do you draw the line? That is a difficulty we are trying to solve.

Mr. **Brickfield**. Well, first of all, the Tax Code so provides it, and we also draw the line on volume fees, and things like that because our needs are very great, and therefore we need the income to meet these needs. And I tell you, Mr. Chairman, you cannot do it on dues alone, and as we see the specific needs of our elderly we seek to meet it whether you call it travel, or call it pharmacy services.

And yes, there are other organizations out there, commercial, that can provide those services, and those other organizations compete with our endorsed organizations on a tax competitive basis.

What we are saying is that we take a very special interest in our membership, and we seek out a travel service, for example, that we can set the standards for, and we can monitor, and this is the way we proceed.

Chairman **Pickle**. Well, the Treasury made the statement at the very first of these hearings, that a lot of these organizations are expanding their operations, and they are doing it because they just need to get the income, and they justify almost any additional service they render on the basis that they just need the income, and it goes for a good purpose.

And that may or may not be true. But the question is, in all of these operations, most of them do not pay any UBIT, and we are having a hard time finding out who does pay the tax. Organizations just do not volunteer the information.

Not many of your organizations are coming here and saying that you have paid any UBIT at all. And so, on this basis, you have to ask yourself, will there be any curtailment in the growth of commercial activities of the tax-exempt organizations? There are over a million of them now.

Mr. BRICKFIELD. Well, I think——

Chairman PICKLE. And not counting churches. So we ask ourselves, why are the commercial activities of exempt organizations growing? And obviously growing because it is one means of giving the public needed service and they do not have to pay tax on the income.

I am not saying it is not a good thing for the public. I am not arguing that. But I am trying to say how do we handle it as an agency of Government?

Mr. BRICKFIELD. Well, I think another witness here this morning, or this afternoon, might have given or suggested a pretty good tool. What is related, and what is not related, is usually a question of fact to be determined in individual cases.

And so we need stronger enforcement of the provisions of the statute. We also need a greater strengthening of IRS with more investigators and enforcers in order to do a better job. I think this is the way to go. You need stronger enforcement capabilities and you have got to give the agencies that have the responsibility for policing this program the tools and the financial support to carry them out.

Chairman PICKLE. I notice that most of you just say you need stronger enforcement. I am particularly impressed, Mr. Geer, that you represent a national organization, and you are an exempt organization, and yet you represent for-profit organizations. I have talked to the group in my State, and in my own city. There are 100 to 150 members of the Texas State Society of Executives.

Now you represent a national tax-exempt association. You do not want any changes. You said that your members do not pay UBIT, and you want to keep the law like it is. And yet many of the membership of your national association are the very ones who are complaining to us that they are going out of business, or are hurting because these organizations are growing and they are tax-exempt.

Now do you feel some kind of inconsistency in your position? Here you are, a national association, representing the for-profit organizations, and it seems to me like you are willing just to say, well, it is not too bad, we will just accept it like it is, and we will go ahead.

Mr. GEER. Mr. Chairman, the American Society of Association Executives does not represent for-profit institutions. It represents nonprofit trade associations and professional societies only.

Chairman PICKLE. Well, but most of those trade associations are not just nonprofit. They are in business, whether it is medicine, whether it is dentistry, whether it trucking, whether it is restaurant, and so forth.

Mr. GEER. Well, as I pointed out in the statement, a percentage of them are engaged in unrelated business activities, and they do step up and pay their taxes on it, consistently.

Chairman PICKLE. Well, then, you do not feel any sense of inconsistency between your position and your association's position?

Mr. **Geer**. I agree with the statement I heard earlier, that there is a need, an important need, for more strict enforcement, for more experienced personnel who are auditing not-for-profit organizations as contrasted with for-profit, because it is a unique and diverse enterprise which perhaps requires some special expertise and training.

Chairman **Pickle**. But your organization, your associations on the State level, have not objected to the position you are taking? Is there any division within your association on this question?

Mr. **Geer**. Not to my knowledge.

Chairman **Pickle**. I am surprised to hear that. We will explore that further ourselves.

Well, I would like to ask you gentlemen some further questions, but we have another panel, and it has been a long day. So we will cease our questions at this point, but we ask you to comment specifically about some of the Treasury's recommendations, and we will be in touch with you through the staff. Thank you very much.

[The following were subsequently received:]

National Geographic Society

WASHINGTON, D. C. 20036

GILBERT M. GROSVENOR
PRESIDENT

July 22, 1987

Congressman J. J. Pickle
242 Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

At the conclusion of our testimony before your Oversight Subcommittee several weeks ago, you requested that panel members comment on the Treasury Department's views concerning the appropriate tax treatment of income-producing activities of exempt organizations. The National Geographic Society's perspective is as follows.

Mr. Chapoton's comments are thoughtful and his recommendations for areas of improvement in the administration of the unrelated business income tax appear to us to be generally sound. As he noted in his introductory remarks, the subject matter of the hearings affects a large and diverse group of organizations that engage in an equally broad range of activities.

The Society approves the Treasury's endorsement of the "substantial relationship" standard for determining exemption from tax of various activities of exempt organizations. More guidance may be needed from the I.R.S. as to the applicability of the test under various scenarios (and perhaps stricter enforcement). However, the standard itself is sensible, balanced, and draws reasonable distinctions among competing interests.

As to Mr. Chapoton's second major category for consideration (businesses operated by volunteers or for the convenience of students, patients and others and the sale of donated property), I have no comment since the Society does not engage in these activities.

Concerning the proper allocation of expenses between related and unrelated businesses, for purposes of determining an exempt organization's unrelated business taxable income, it may be (as I noted in my oral testimony) that certain of the rules for allocation could be clarified or revised to more accurately reflect business use. However, with the possible exception of the Rensselaer Polytechnic Institute situation, which Mr. Chapoton discusses at some length, I would suggest that allocation inequity issues generally can be appropriately and adequately addressed through regulation rather than legislative amendment.

Mr. Chapoton's fifth category for further study is certain aspects of the "passive" income exclusions from the unrelated business income tax. We note approvingly the Treasury's sensitivity to the importance of investment income to public charities and its endorsement of the continuation of this tax exemption.

He does, however, specifically discuss a potential narrowing of the definition of royalties to be excluded from taxation. We endorse Treasury's position that a royalty return for the mere right to use one's name or trademark in connection with an otherwise unrelated commercial product should not be considered tax exempt. However, where the organization is granting a license that furthers the dissemination of information related to its exempt purpose (rather than merely extending the right to use its name or trademark in connection with a commercial product) a valid royalty payment situation would appear to have been created, and we would suggest that the royalty exclusion from taxation should apply.

The Society will not comment on Mr. Chapoton's fourth category (controlled subsidiaries), sixth category (research activities) or seventh category (partnerships) because we are not engaged in those activities and, therefore, do not believe that we have any expertise or information that would be useful to the Subcommittee in its further deliberations.

Thank you for the courtesy you and your Committee members extended to me during my presentation. If the National Geographic Society can be of further service to you, we would be happy to oblige.

Sincerely yours,

Gilbert M. Grosvenor

Gilbert M. Grosvenor

asae

AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES
The ASAE Building
1575 Eye Street, NW
Washington, DC 20005-1168
202-626-ASAE
TLX 262115

July 22, 1987

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
House Ways and Means Committee
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

The American Society of Association Executives (ASAE) applauds the efforts of the Oversight Subcommittee in reviewing the unrelated business income tax (UBIT) and its appropriateness for tax-exempt organizations.

We also welcome the Treasury Department's testimony in this area, chiefly its conclusion that further information on the tax-exempt community is needed before specific changes can reasonably be considered.

With regard to Treasury's initial recommendations, ASAE would like to bring the following comments to your attention:

1) We agree with Treasury that the "substantially related" test in the UBIT statute provides a sound basis for granting exemption from tax. Furthermore, we concur that the standard would be difficult to improve upon and that no changes are needed at this time.

2) We also agree that more complete and reliable information is needed on the activities of tax-exempt organizations. Accordingly, ASAE fully supports expanded reporting requirements through revision of Internal Revenue Service Forms 990 and 990-T. Our President, R. William Taylor, CAE, serves on the Form 990 Committee and will be participating in this process. We have also developed a dialogue with the IRS, seeking to provide data on the activities of trade and professional associations represented by ASAE members. Such information on the wider tax-exempt community will no doubt provide the cornerstone for further review of the adequacy of the UBIT statute.

3) As we stated in our testimony before the Subcommittee, ASAE believes that administration and compliance with UBIT can be improved. In this we again agree with the Treasury Department's testimony. We suggest that the IRS strictly enforce current UBIT rules, audit more returns, and provide more accessible information in order to increase general understanding of the statute.

4) ASAE supports the Treasury Department's proposal to clarify rules for allocating expenses, reflecting the appropriate relationship between an organization's exempt functions and unrelated activities. In addition, we support Treasury's view that the fragmentation rule should be retained, as well as its recommendation to increase the specific deduction from unrelated business income from $1,000 to $5,000.

5) ASAE agrees that the definition of a "controlled subsidiary" could be broadened to include subsidiaries in which a tax-exempt organization has more than a 50 percent interest. We also agree that, in certain cases, the activities of an exempt organization and its subsidiaries could be aggregated in order to determine whether the group's primary purpose is to carry out an exempt function.

6) ASAE concurs with Treasury's statement that passive income activities are generally not subject to abuse. We agree that such income should continue to be tax-exempt for 501(c)(3) public charities, but should be taxable to 501(c)(4) social welfare organizations unless permanently set aside for charitable purposes.

7) ASAE does not believe, however, that the passive income of 501(c)(6) trade associations should be taxable. These groups serve to promote business conditions, benefitting the general public. Since trade associations do not have private owners or stockholders for capitalization, the only way they can build stability and security is to spend less than they take in. This equity build-up of reserve funds is usually maintained in investments, producing income which the organization then uses to fund programs related to its exempt purpose. Many trade associations (including ASAE) attempt to build such a reserve for future growth, as well as for stability during economic downturns.

In our view, it would be inappropriate to consider applying UBIT to the passive income activities of trade associations. First, ASAE's surveys indicate that the average association derives just over percent of its total income from investments, and under 3 percent from other passive sources. Second, any short-term revenue gain to the federal government as a result of such a tax would almost certainly be negated over the long run. Most trade associations would have to scale back their activities, resulting in the need for more government intervention. Associations that sought to maintain all their traditional services would be forced to increase dues or fees to members. Since these are generally deductible to businesses under current law, the tax burden would effectively be shifted from corporate members to the associations themselves - which are taxed at a lower rate in any case.

The upshot of these arguments is that many trade associations rely on passive income to carry out their tax-exempt purpose. Passive income activities ultimately benefit the public and reduce the burden on government. Application of UBIT in this area would not produce significant revenue, and ASAE would not support such a change.

8) ASAE agrees with the Treasury Department that the current exclusion for royalties could be narrowed to prevent avoidance of UBIT in certain circumstances.

9) We also agree that the exclusion for income derived from certain research activities is generally appropriate. We concur with Treasury's suggestion that attention should be given to more clearly defining basic research, as well as to developing specific requirements for public dissemination of research findings.

10) ASAE would support a reexamination of the exclusion applying to activities conducted for the convenience of members, students, patients, officers, or employees of 501(c)(3) organizations. Similarly, we would support reexamination of the exclusion applying to income-producing activities carried out by volunteers.

11) Lastly, ASAE agrees with the Treasury Department's assessment that current restrictions on partnership allocations between taxable and tax-exempt partners may not be adequate to prevent abuse. Further study of issues raised by tax-exempts' joint ventures may also be appropriate.

Mr. Chairman, the American Society of Association Executives hopes that these comments will be helpful to the Oversight Subcommittee as it evaluates the Treasury Department's testimony and develops recommendations based on the recent UBIT hearings. We appreciate your Subcommittee's in-depth review of this entire area, and will be providing further information on the activities of trade and professional associations as it becomes available.

Thank you for the opportunity to comment on the Treasury proposals. We look forward to working with you in the future.

Sincerely,

Jim Albertine

James J. Albertine
Director of Government Affairs

JJA/mj

cc: R. William Taylor, CAE
Malcolm Karl

Comments of the American Association of Retired Persons Concerning the Treasury Department Testimony

During the June 1987 hearings before the Subcommittee on Oversight of the Committee on Ways and Means, the Department of the Treasury recommended that the Subcommittee consider seven areas for possible legislation regarding the treatment of income-producing activities of tax-exempt organizations. Chairman Pickle requested the organizations that testified before the Subcommittee to submit comments concerning the Treasury Department testimony. The American Association of Retired Persons ("AARP") submits this document in response to Chairman Pickle's request.

1. The "Substantially Related" Standard.

The Treasury Department believes the current standard of a substantial relationship to an organization's exempt purpose has conceptual merit as the basis for granting exemption from tax for the business activities of exempt organizations. However, the Treasury Department expresses concern that the implementation of the test has provided inadequate guidance to exempt organizations, the Internal Revenue Service and the courts. As a result, the Treasury Department recommends more detailed reporting as a means of improving enforcement and compliance and of providing a basis for further review of the adequacy of the standard.

AARP agrees with the Treasury Department that the relatedness standard is fundamentally the correct test. Tax exemption should appropriately extend to those activities that are substantially related to the purposes for which the organization receives tax-exempt status. To the extent the Treasury Department believes further guidance should be provided to improve the administration of this standard, the Treasury Department and Internal Revenue Service have the power to take the necessary actions.

2. The Volunteer and Convenience Exemptions.

AARP has no comment on this suggestion.

3. Computation of UBIT.

AARP has no comment on this suggestion.

4. Unrelated Business Carried on by Subsidiaries.

The Treasury Department suggests broadening Section 512(b)(13) to tax passive income from subsidiaries in which an exempt organization has more than a 50% interest by value or voting power. The Treasury Department further suggests that consideration be given to aggregating the activities of an exempt organization and its subsidiaries in appropriate cases for purposes of determining whether the parent oganization's primary purpose is the conduct of an exempt function.

AARP has no comment with respect to the Treasury Department's first suggestion. With respect to the second suggestion, AARP notes that if the Subcommittee decides to pursue the Treasury Department's recommendation a careful evaluation will be needed of the types of cases deemed to be appropriate. The Treasury Department states that it is not aware of any actual cases which demonstrate its concerns. If, despite this, the Subcommittee concludes legislation may be warranted, AARP believes the Congress should avoid a rigid formula for determining whether an exempt organization is required to take into account the activities of its subsidiaries. A rigid formula would not accurately reflect the value to the exempt organization of many of its resources such as, in the case of AARP, the work performed by its 350,000 volunteers.

5. Passive Income.

The Treasury Department suggests that the passive investment income of social welfare organizations should be taxable unless paid or permanently set aside for charitable purposes. Historically, the tax policy has been to exempt the investment income of social welfare organizations on the ground that such organizations serve a public rather than a private interest.

Unlike the Treasury Department's other suggestions, this suggestion is not motivated by concern over the business activities of exempt organizations that has been the principal focus of the Subcommittee's hearings. Rather, the Treasury Department's proposed change arises from its concern that investment income of tax exempt organizations is being utilized for lobbying purposes. However, excluding investment income only to the extent it is set aside for charitable purposes ignores the distinction between Section 501(c)(3) and 501(c)(4) organizations. While AARP believes that most of its activities and expenditures are for charitable purposes, certain non-lobbying expenditures for valid social welfare purposes might not qualify as charitable.

AARP believes that all expenditures consistent with its social welfare purposes are legitimate uses for investment income. Thus, it is AARP's position that the current exemption of the investment income derived by social welfare organizations is justified by (i) its use for public welfare purposes, (ii) the fact that the proposed change is not necessary to protect competition, and (iii) on the basis of preserving the distinction between organizations exempt under Section 501(c)(3) and 501(c)(4) of the Internal Revenue Code.

If a change were to be made, AARP recommends that the taxable amount should be limited to the excess of (A) the amount of investment income over (B) the amount expended or permanently set aside for the purposes described in Section 501(c)(4) of the Internal Revenue Code other than lobbying. This would more accurately reflect the basis of the Treasury Department's position which seeks to preclude the use of investment income to conduct lobbying activities.

Within the category of investment income, the Treasury Department has made additional recommendations regarding royalties. As the Subcommittee knows from AARP's written and oral testimony, AARP endorses various services offered by tax-paying providers from which it derives royalty income. AARP does not provide these products and services itself, which would involve AARP in activities beyond those reasonably necessary to accomplish its exempt purpose, nor does it establish these programs merely to raise revenue. Rather, AARP endorses a product or service only after determining that, by doing so, it can benefit its members through a product or service designed to meet their needs as older Americans. AARP's royalties are fixed according to a percentage of receipts derived by the service provider, not on the net profits of these business enterprises.

The Treasury Department recommends that the definition of royalty exclude amounts measured by net profits, a proposal with which the Association has no disagreement. For the remaining royalty situations, AARP feels that royalties should continue to remain tax-exempt so long as the payment meets the general passive investment income test discussed earlier in these comments, namely whether the funds are devoted to purposes described in Section 501(c)(4) other than lobbying.

6. Research Activities

AARP has no comment on this suggestion.

7. Joint Ventures.

AARP has no comment on this suggestion.

* * *

AARP would be pleased to answer any further questions the Subcommittee may have on these or other aspects of the unrelated business income tax.

Chairman PICKLE. The next panel will consist of Richard Meives, Horace Hodges, James Crowson, and Douglas Ducate.

Let me say, before people leave the room, that we will resume the hearings on this subject tomorrow morning at 9 o'clock. The hearing will be in room B-318 instead of this room, 1100 Longworth.

This panel consists of Mr. Richard—is it Meives?

Mr. LUMERMAN. Mr. Chairman, my name is David Lumerman. I am standing in for Mr. Meives.

Chairman PICKLE. And yours is David——

Mr. LUMERMAN. Lumerman, L-u-m-e-r-m-a-n.

We informed the committee Friday.

Chairman PICKLE. All right. Mr. Lumerman.

You are representing the Fraternal Order of Police from the Illinois State Troopers Lodge?

Mr. LUMERMAN. That's correct, sir.

Chairman PICKLE. Then we've got Horace Hodges, immediate past president of Fraternal Order of Police, State Lodge of Alabama.

Mr. HODGES. That's correct, sir.

Chairman PICKLE. Then I've got the University of Texas, Jim Crowson, a good friend for many years.

And then we have Douglas Ducate representing the National Association of Exposition Managers.

Well, David Lumerman, you may proceed first.

STATEMENT OF DAVID LUMERMAN, FRATERNAL ORDER OF POLICE, ILLINOIS STATE TROOPERS LODGE NO. 41

Mr. LUMERMAN. Mr. Chairman, members of the committee, I represent the Fraternal Order of Police, the Illinois State Trooper Lodge No. 41. They are a 501(c)(8) organization.

They publish the Trooper magazine, and this Trooper magazine goes out to about 3,000 individuals, about 2,000 State troopers and related members of the organization. In connection with this publication, they solicit contributions. Now, they recognize these contributions by putting lists and advertisements, or what you might call listing ads in the magazine.

Now, the issue that we placed before this committee, as Mr. Pickle stated, is where does the UBIT come in? We are asserting that whether the solicitation of contributions is actually advertising income. In order to be taxed as unrelated business income under the code, the income must be derived from a trade or business not related to the exempt organization.

And I believe that Congress' primary purpose in taxing this income was to eliminate a source of unfair competition with nonexempt businesses and other organizations.

Now, the FOP has maintained its activities are strictly fundraising, and that the moneys solicited are contributions and are not the trade or business of commercial advertising.

Now, in recognition of a contribution that business has given what we deem a listing in Trooper magazine, this listing is either a block type display or a listing in the business directory which just lists the contributors and may say compliments of, or some other type of recognition of the listor.

Now, the IRS and the Tax Court subsequently audited the FOP, the Fraternal Order of Police, and have ruled that these listings constitute advertising and that they constitute the carrying on of a trade or business. Now, what has been alluded to before in this committee hearing was a case of *United States* v. *American College of Physicians*. In that case, the Supreme Court issued what we feel is a limited ruling, holding that the advertising in the medical journal published by the college was commercial advertising, and did not relate to the educational purpose.

In the operative phrase, there was commercial advertising, which follows the Treasury regulations, by the way, to define a trade or business as commercial advertising. And I believe what is abundantly clear in our situation and situations similar to this, which would include things like high school yearbooks, or any other type of publications with an exempt organization, that the material, what is deemed advertising is in fact not commercial in either its content or its style. The material is not meant to sell any products. It is only meant to display the name of a contributor. It is essentially recognition of a contributor. And those making a contribution expect no commercial benefit for it.

As I said, the Trooper magazine goes to maybe 2,000 State troopers within the State of Illinois. And the payment for, or the contribution made by what would be deemed the advertiser would not benefit him in any commercial way. The FOP's approach is solicitation for a contribution. What they give to the trooper is in a sense a contribution and is in no way considered by the advertiser or the contributor as getting a commercial benefit.

On the other hand, in the materials we have given you, we have given you examples of the Trooper magazine advertisements, starting with exhibits A, B, C and D, you can see that these ads are not professional in style. They are created by the publisher. They generally just will block out the name of the organization, many times no address. If a telephone number is there, there is no area code. Illinois has four or five area codes. It would be impossible for a trooper to use this type of directory to buy or purchase services or products.

Starting with exhibit—well, going to exhibit D, which is a large block ad, is an advertisement for MidAmerica Utilities which, in no way, a trooper would be using the services of this utility in any real commercial sense. And it pretty much is a block ad created, not to sell a product, but just to acknowledge a contribution by the utility company.

Starting with exhibit E, we have advertisements from a magazine called the Police Chief, and there's other magazines called Police Magazine, and Law and Order. These publications, although they may be from exempt organizations, are, advertising to sell a product. These are commercial advertising, what would be deemed in the regulations commercial advertisements. And these would be subject to UBIT, whereas we're of the opinion that the type of listing or advertising in the Trooper magazine certainly should not be subject to this tax.

I will just conclude briefly that the Tax Court decision, I believe, is overbroad and I believe contrary to the intent of Congress. And I think we do need more legislation to make this clearer. And we're asking you to clarify this area, so that only commercial advertising should be taxed, and that the recognition of contributors through the listing types found in the Trooper and other types of publications, such as yearbooks, in-house editions of not-for-profit type organizations do not constitute commercial advertising, and that a legitimate fund raising activity should not be transformed into UBIT just because the contributor is recognized in print in a listing medium.

Thank you.

[The statement of Mr. Lumerman follows:]

STATEMENT OF FRATERNAL ORDER OF POLICE, ILLINOIS STATE TROOPERS LODGE NO. 41 ON THE UNRELATED BUSINESS INCOME TAX TO THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES

The Internal Revenue Service is applying the unrelated business income tax to a particular type of fund raising activity widely employed by exempt fraternal police organizations throughout the country. This application of the unrelated business income tax (hereafter UBIT) to a legitimate fund raising activity which is not a commercial enterprise and does not compete with any commercial business is contrary to the Congressional intent behind the UBIT. Furthermore, because of its overbroad reading of the widely publicized Supreme Court case, U. S. v. American College of Physicians, the Tax Court has in effect approved the Internal Revenue Service's application of the UBIT to such fund raising acitivity. The fund raising activity at issue typically involves the solicitation on behalf of a fraternal police organization of contributions from businesses and professionals with a contribution being recognized by a listing published in the fraternal police organization's official magazine.

In the case of the Fraternal Order of Police, Illinois State Troopers Lodge No. 41 (hereafter FOP), a magazine called "The Trooper" is distributed to the organization's membership which consists of approximately 2,000 police officers of the Illinois Department of Law Enforcement and troopers of the Illinois State Police. "The Trooper" contains editorial material and articles of interest to law enforcement personnel. The magazine also contains business listings that recognize contributions to the FOP. The size of the listing corresponds to the amount of the contribution. These business listings are of two types. There are large block type listings scattered throughout the magazine and in a separate section at the rear of the magazine there are pages of smaller listings categorized by the type of business. The FOP contracts with a non-exempt commercial organization to solicit business organizations and professionals to make contributions to the FOP. In the past the FOP received 20% of the gross revenues generated from the business listings while the commercial contracting organization received the remaining 80% of the revenues and bore all the costs of production and distribution of the magazine and all costs of solicitations. As explained to the contributors, the contributions received by the FOP were to be applied to the death fund, scholarship fund and other charitable activities of the FOP. The layout of the listing is prepared by the solicitor and not the contributing business. The contributor sees no advance proof of the listing and in fact does not receive a copy of the magazine in which the listing appears.

Attached hereto as Exhibits "A" through "D" are representative pages of "The Trooper" showing both the large block and smaller directory type listings. Clearly these types of listings contained in a magazine that is distributed to approximately 2,000 police officers scattered throughout 102 counties of Illinois cannot considered to be in competition with commercial advertising media for a business's advertising dollar. It is clear that the contributors can only reasonably expect an inconsequential commercial benefit from any listing in "The Trooper." Some listings contain no address and do not list the city location; from many listings it is not even clear what product or service the contributor provides.

Compare the slick copy of genuine advertisers contained in three different magazines aimed at the police audience: Exhibit "E" is from "Law and Order," Volume 31, No. 3, March 1983, Exhibit "F" is from "The Police Chief," April, 1983 and Exhibit "G" is from "Police Magazine," September, 1982. These advertisements are professionally done and are attempting to sell a product or service to the police readership of the magazine. Absent from "The Trooper," however, are advertisements for police shotguns, bulletproof vests, armored vehicles, police radios and night sticks.

The Internal Revenue Service has recognized for some exempt organizations that sixty listings per page generates such an inconsequential commercial benefit to the listing business that the revenue derived therefrom does not constitute unrelated business taxable income, see Rev. Rul. 76-93, 1976-1 Cum. Bull. 170. The IRS, however, has developed a separate rule for police organizations which treats the revenue derived from such multiple listings as unrelated business taxable income, see Rev. Rul. 74-38, 1974-1 Cum. Bull. 144. The IRS explains its disparate treatment with the rationale "... that the goodwill expected to be derived from the identification of the firm in the manner described therein is considered a form of commercial benefit that would be more than inconsequential." Rev. Rul. 76-93, supra. Consequently, not only has the Internal Revenue Service failed to recognize the obvious distinction between commercial advertising and mere recognition of contributors, it has in fact created a separate and more onerous rule to be applied only to police organizations.

The FOP's particular case has been litigated in the U. S. Tax Court, resulting in a decision in favor of the Internal Revenue Service. 87 TC__, 45 (1986). An appeal of that decision is pending before the U. S. Court of Appeals for the Seventh Circuit. Briefing of the appeal has not been completed and a date for oral argument has not been set. It appears that the Tax Court's decision was based on an over broad reading of the U. S. Supreme Court's opinion in U. S. v. American College of Physicians, 475 U.S. , 89 L.Ed. 841 (1986). The advertisements at issue in the American College of Physicians case were clearly designed to sell a product to a specific audience. That is, pharmaceutical companies were running ads for prescription drugs in the Annals of Internal Medicine, a highly respected publication. The issue in the American College of Physicians case was whether the admittedly commercial advertising was substantially related to the organization's exempt purpose, that is, the furtherance of medical education among physicians and thus not subject to the unrelated business income tax. The Supreme Court held that the advertisements were not substantially related to the organization's exempt purpose. Consequently, the issue present in the FOP case was not considered by the Supreme Court. Arguably, the Supreme Court implicitly supports the FOP position because the Court often used the terms "commercial advertisements" in its opinion suggesting that the Court recognizes that Congress did not intend to tax mere business listings that had negligible commercial value to the business. The Tax Court, however, simply did not analyze the implicit requirement that a listing be commercial in nature to constitute advertising that should be subject to the unrelated business income tax.

We ask Congress to make it clear that only commercial advertising should be taxed and that the recognition of contributors through business listings of the type found in "The Trooper" does not constitute commercial advertising. Furthermore, at the very least, the Internal Revenue Service should be prevented from applying more onerous rules to police organizations. A legitimate fund raising activity should not be transformed into an unrelated business activity simply because the contributor is recognized for its contribution in print.

Respectfully submitted,

Richard L. Meives

Richard L. Meives
Counsel for The Fraternal Order
of Police, Illinois State
Troopers Lodge No. 41

Vassen, Vetter & Meives P.C.
1801 North Belt West
Belleville, Illinois 62223
618-277-8700

June 11, 1987

QUALITY FARM EQUIPMENT

209 S. Belt East
Belleville, Il. 62220
233-0068

RATHGEB BROS. TRACTOR EQUIPMENT CO. — Massey, Ferguson, Case
500 W. Main, Box 510
Carlinville 854-7211

RAYMOND IMPLEMENT CO.
Box 188, Raymond 229-4217

STAMME FARM EQUIP. CO., INC.
Hwy. 140 1 Mile East of Hamel
P. O. Box 187
Hamel 633-2626

TETZLOFF FARM SUPPLY
Hwy. 108, Carlinvl 854-3728

WEISENFELD, GEORGE A. & SON INC.
189 N. Cherry, Breese 526-7725

Farm & Hide Broker

ELLIOTT, GEORGE H. CO.
130 N. Wells, Chicago 372-4042

Farmers

KAUFMAN FARMS
Larry Kaufman
Alhambra
Illinois 62001 488-3725

Feed Dealers

FARM FEED CONSTRUCTION CO.

402 S. Clinton
Aviston, Il. 62216
228-7702

TROST FEED & SUPPLY CO.

Maeystown Rd.
Maeystown, Il. 62256
458-7712

Fence

METRO FENCE CO.
2107 E. A St.
Belleville
Illinois 62221 233-0176

Fertilizers

MEYER FERTILIZER & CHEMICAL
R. R. 1, Whitehall 374-6054

Film Service

LANGLEY'S FILM SERVICE
606 W. Pine, Greefld 368-2350

Filters

SPECIALTY FILTER SERVICE
10 Hlcrst., Caseyvl 397-0338

Financial Consultants

FISCAL MANAGMENT CORP.
Financing, All Kinds - Any Amount
100 W. Monroe
Chicago 236-4422

Fireplaces

ALTON FIREPLACE CENTER
"WE BUILD FIREPLACES"
- Air Circulating Fireplaces
- Wood Burning Stoves
- Quality Stone Work

Free Estimates
Free Parking

626 E. Broadway
Alton, Ill. 62002
465-4850

Fireplaces And Alarms

FIREPLACE SHOPPE
☆ Complete Line ☆ Accessories
☆ Installation
CUSTOM FIREPLACES AND ALARM SYSTEMS
Fireplace and Protection Agency
108 W. Main St.
West Frankfort, Il. 62896
937-2937

Floor Drain Grates

IODON INC.
18610 S. John
Country Club Hills
Illinois 60477 799-4067

Floor Laying & Covering

LOWELL STONE FLOOR LAYING

2150 Martin Luther King
E. St. Louis, Il. 62205
874-2552

LUCY LEE'S FLOORING & DECORATING

4428 N. Belt W.
Belleville, Il. 62221
277-5540

MATTCO INTERIORS
Caseyville 398-5808

Floor Traders & Broker

CHANCELLOR DOUGALL & CO.
120 S. Lasalle
Chicago
Illinois 346-1066

Florists

ALLIED FLORIST ASSOCIATION OF ILLINOIS — Chicago 666-1818

CARLE'S FLORIST & GREENHOUSES
Flowers for all occasions

Adele Ohl
1320 W. Main
Mascoutah, Il. 62258
566-2959

FIRNHABER FLORIST
216 W. Main, Staunton ... 635-2288

FLORIST & GIFT SHOP 286-4303

LITCHFIELD FLORAL 324-3422

Food Products

WATKINS PRODUCTS 277-8900

WILTON ENTERPRISES 963-7100

Food Systems

LANDSHIRE FOOD SYSTEMS
Havana, Ill.
1 - 309 - 543-2770
Mattoon, Ill.
217 - 234-6346
Sikeston, Mo.
314 - 471-6143

Landshire®
9200 W. Main St.
Belleville, Il. 62223
398-1990

Formal Wear

JIM'S FORMAL WEAR RENTAL CO.
11 E. Wisc., Trenton 224-9211

Foundation Contractors

WEISS, L. A. FOUNDATION
4640 N. Marine Drive
Chicago
Illinois 728-7373

Foundries

EXCELSIOR FOUNDRY CO.
Grey Iron Castings

1123 E. B. St.
Belleville, Il. 62222
233-0232

FOUNDRY ALLOYS INC.
704 Indiana, Beecher 946-2627

Fraternal Organization

MOOSE HOME LODGE 259-0069

Freight Forwarders

TWIN CITY SHIPPERS INC.
348 N. Clinton
Chicago
Illinois 236-4551

Freight Rates

MO. ILL. TRAFFIC SERVICE
East St. Louis 271-6300

Frigidaire Products Sales And Service

EAST SIDE SERVICE CO.
5021 W. Washington
Belleville
Illinois 62223 233-2200

Fruit Orchard

RANDLEMAN, GROVER & SONS

Hwy. 127 N.
Alto Pass, Il. 62905
893-2771

Fruits & Vegetables

DIEHL STRAWBERRY & VEGETABLE FARM — Columbia 281-4929

Funeral Directors

GAERDNER, PETE FUNERAL HOME

250 Lebanon Ave.
Belleville
234-0419

HAMPEN FUNERAL HOME

Funeral Directors

15 E. Hanover
New Baden, Il. 62265
588-3533

KASSLY, HERBERT A. FUNERAL HOME
515 Vandalia
Collinsville
Illinois 62234 344-5500

MAAS FUNERAL HOME 839-2155

MERIDITH FUNERAL HOME
920 9th. St.
highland 654-2155

WAGNER-BODE FUNERAL HOME
Licensed in Illinois and Missouri
Kenneth Bode
218 W. 4th.
Waterloo, Il. 62298
939-7111

WILLIAMSON FUNERAL HOMES
Home Office
108 W. Henry St.
Staunton 635-2442

WOLFERSBERGER FUNERAL HOME
102 W. Washington
O'Fallon
Illinois 62269 632-3681

Furnace Repairing & Svc.

FURNACE CARE CO. OF ILLINOIS
344 George, E. Alton 259-7450

Furniture Dealers

COLLINS HOME FURNISHINGS
Roodhouse 589-4131

FEDER HUBER FURNITURE ... 452-7147

GLANZNER FURNITURE CO.
219 S. Main
Trenton
Illinois 244-9424

EX. A THE TROOPER, MAY 1979

COUNTRY COMPANIES INSURANCE
Paul V. Bishop, CLU
Life
Health
Homeowners
Auto

201 E. Chestnut
Olney, Il. 62450
395-2015

ERWIN INSURANCE AGENCY . . 676-1321
MILLER'S MUTUAL INSURANCE ASSN.
1509 11th.
Lawrenceville
Illinois 62439 943-5314
HUMEYER INSURANCE AGENCY INC.
Belleville 233-0024
RELIABLE LIFE INSURANCE CO. 337-5830
STATE FARM INSURANCE
Box 208, Newton 783-3266
TENNIS, MYLES J.
State Farm Ins. 544-2326

Insurance Adjusters

G. A. B. GENERAL ADJUSTMENT
BUREAU — Olney 393-2169

Insurance Brokers

AMERICAN INTERNATIONAL CO.

222 S. Riverside Plaza
Chicago, Il. 60606
648-8800

Jewelers

ANDERSON'S JEWELRY
109 E. Jefferson, Effingham 342-2010

Janitors' Service

CROSSROADS JANITORIAL SERVICE
Effingham 342-3953

Jewelers

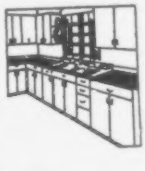
GENE'S JEWELRY
Robinson 544-7011

Kennel

LAWNDALE KENNEL 233-4479

Kitchen Cabinets & Equip. — Household

THE TOP DRAWER
KITCHENS & BATHS
Mon. - Fri. 9 to 5



910 W. Wabash
Effingham, Il. 62401
342-2382

Labor Union

LOCAL 1255 LABOR UNION
Lawrenceville 943-3448

Lawn Maintenance

GREEN LAWNS

633 W. Monroe
Belleville, Il. 62221
734-2141

Liquor Stores

CAROL'S PACKAGE LIQUOR
Effingham 347-7023
LINCOLN LIQUORS
120 S. Lincoln
Centralia
Illinois 532-7165
STU'S PACKAGE STORE
"Let us keep you in the best of spirits" — 117 W. 8th. St.
Mt. Carmel 262-8326

Locksmiths

LOCK & KEY SERVICE

6910 W. Main, Belleville, Il. 62221
397-2679

Machine Shops

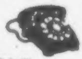
EFFINGHAM REGRINDING INC.
Effingham 342-4186
H & D MOTOR SERVICE
Effingham 342-3262
INDUSTRIAL PARK MACHINE TOOLS
S. Chicago Heights 754-7080

Manufacturers' Agents & Representatives

H. P. COMPANY
Box 172, Robinson 544-32210

Marine Performance Ctr.

HYLSKY MARINE PERFORMANCE CENTER —
Bank Financing
Jim Hylsky - Owner



305 S. Belt W.
Belleville, Il. 62221
277-0233

Marine Supplies

DORI AUTOMOTIVE & MARINE SUPPLY
Charles Dori Jr. - Pres.

EVINRUDE

First in Outboards

6308 N. Illinois Hwy. 159
Fairview Hghts. Il. 62208
632-4066

Marketing

MAHONEY, JACK & ASSOCIATES
500 N. Mich., Chicago 644-6446

Milk Distributor

R. B. MILK DISTRIBUTORS
Chicago 389-0224

Molders

CUSTOM MOLDERS

Best
Wishes

R. R. 5
N. Irvington, Il. 62801
533-2595

Monuments

CLARK MEMORIAL SHOP
Newton 783-2911

Motels

ARVIN MOTEL 544-2143
BEST WESTERN MOTEL
Hwy. 32 N, Effingham 347-7137
GOLD STAR MOTEL
R. R. 3
Robinson
Illinois 544-3503
HOLIDAY INN

U. S. Hwy. 40 W.
Effingham, Il. 62401
342-4161

Mortgages

RANEY & ASSOCIATES 347-7252

Motorcycles & Motor Scooters —

JACK'S HARLEY DAVIDSON SALES & SERVICE — Effingham 342-3494

Motors & Transmissions

DAVE'S MOTOR & TRANSMISSIONS
512 Freeburg
Belleville
Illinois 233-4962

Moving & Storage

METRO EAST TRUCK SERVICE INC.
7000 Old St. Louis Rd.
Belleville
Illinois 62223 235-2740

Newspaper - Publishers & Printers —

MERCURY INDEPENDENT
Grayville 375-3131

Non-Dairy Products

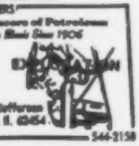
ELGIN-HONEY HILL CORP. 722-7100

Nurserymen

McDEVITT NURSERY 342-2579

Oil Exploration

BELL BROTHERS
Producers of Petroleum
In Illinois Since 1906



201-3 N. Jefferson
Robinson, Il. 62454
544-2158

Oil Exploration & Production —

RANDALL, RUSS INC.
Oil Exploration & Production

Oil Producers

1011 15th. St.
Lawrenceville, Il. 62439
943-6015

Oil Field Construction

HATFIELD, BOB
1012 N. Henrietta St.
Effingham
Illinois 342-2883

Oil Field Service

B. H. OIL FIELD SERVICE
3 Miles West of Eaton Rd.
Robinson
Illinois 62454 569-4512
CLYDE MASON WELL SERVICING CO.

100 S. Court St.
Grayville, Il. 62844
375-4411

ILLINOIS CASING PULLING CO.
Neill O'Neill
Jack O'Neill

Box 157
Grayville, Il. 62844
375-8731

Oil Field Supplies

GENERAL OIL FIELD SUPPLY CO.
Box 38, Olney 392-3461
KEMP'S OIL FIELD SUPPLY
Oil Field Equipment
North 3rd. St., Box 49
Carmi 382-7830
NATIONAL SUPPLY CO.
Rt. 1, South
Lawrenceville
Illinois 62439 943-2351

Oil Producers

FEAR & DUNCAN OIL CO.
Box 218, Salem 548-2923

EX. B THE TROOPER, MAY 1979

Best Wishes from

H. & H. Operating

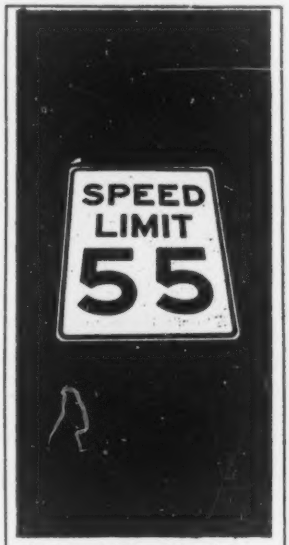
1909 S. 15th St.
Lawrenceville, Ill.

WABASH TIRE & AUTO CENTER
DIVISION OF WABASH INDEPENDENT OIL CO.

707 E. Fayette • Effingham, Ill. • 342-9755

PROCESS PIPING CO.
Fabrication Division

Post Office Box AG, Bunker Hill, Illinois 62014
(618) 585-4904 • (314) 241-7396

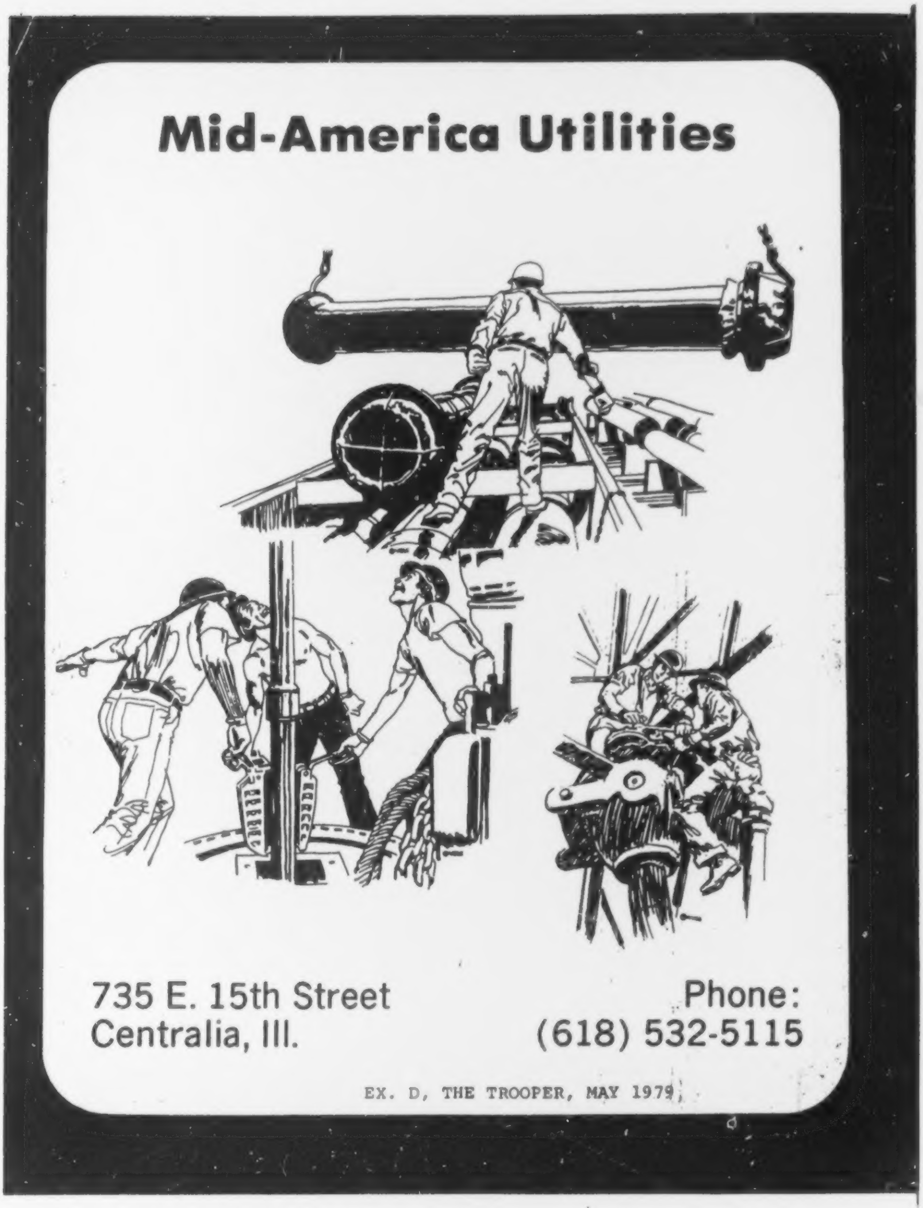


Sponsored By: Attorney Ben Urban

Ronald A. Parker
Excavating Inc.

Richton Park, Illinois 60471
22453 Pleasant Drive
312-748-0112

EX. C, THE TROOPER, MAY 1979



Mid-America Utilities

735 E. 15th Street
Centralia, Ill.

Phone:
(618) 532-5115

EX. D, THE TROOPER, MAY 1979

capture the suspect.

5. Ability to determine that all suspects have been found.

STEP SIX

The first five steps of this program should be repeated several times. This provides officers practical experience in a vital, and often overlooked area of their craft. It allows them to relax their initial distrust of a strange situation . . . and lets them fall into the "routine" trap.

Your instructor/observers will also be able to pinpoint areas where extra training, or different training approaches are needed for future recruit classes.

STEP SEVEN

Without informing anyone other than the suspect and the observers, arm the suspect with a .38 revolver and a shotgun. The weapons should be loaded with safety blanks under strict supervision. The suspect must be thoroughly instructed in the safe use of blank cartridges. An improperly used blank, can be lethal at close range.

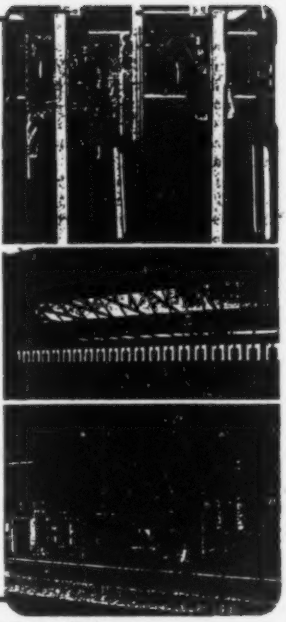
When the searching officers begin trying to locate the suspect, they should receive some very nasty, but very educa-

INDOOR-OUTDOOR
SHOOTING RANGES
POLICE
SECURITY
COMMERCIAL

Our complete line of range equipment is designed and manufactured to meet your specific training requirements. Durable safety-engineered products and latest state-of-the-art technology has made the name DETROIT BULLET TRAP DIVISION synonymous with quality shooting ranges. Do it right! Go with the Leader. Call or write for additional information and take advantage of our 40 years of experience in total range design.

DETROIT-ARMOR CORP.
DETROIT
BULLET TRAP
DIVISION
2233 N. Palmer Drive
Schaumburg, Illinois 60195-3899
(312) 397-4070, TWX: 910-693-4824
FIREARMS TRAINING EQUIPMENT

Circle 13 on Reader Service Card



HELMETS
MOTORCYCLE HELMETS
D.O.T. CERTIFICATION
/ TACTICAL HELMETS
NILEJ 1980

BETTER BY DESIGN

MOTORCYCLE
GENERAL DUTY
RIOT HELMETS

FOR LAW ENFORCEMENT
OFFICERS

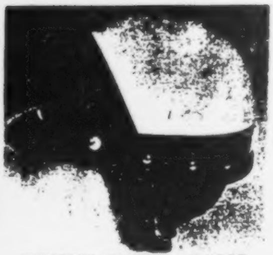
Seer

SUPER SEER CORP., P.O. BOX 700
EVERGREEN, COLO. 80439 U.S.A.
303 674 6663

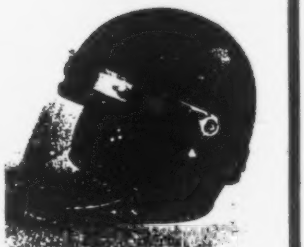
SEER IND., LTD., P.O. BOX 577
FENELON FALLS, ONT., CANADA KOM 1NO
705 887 2306

S-1602

S-1608



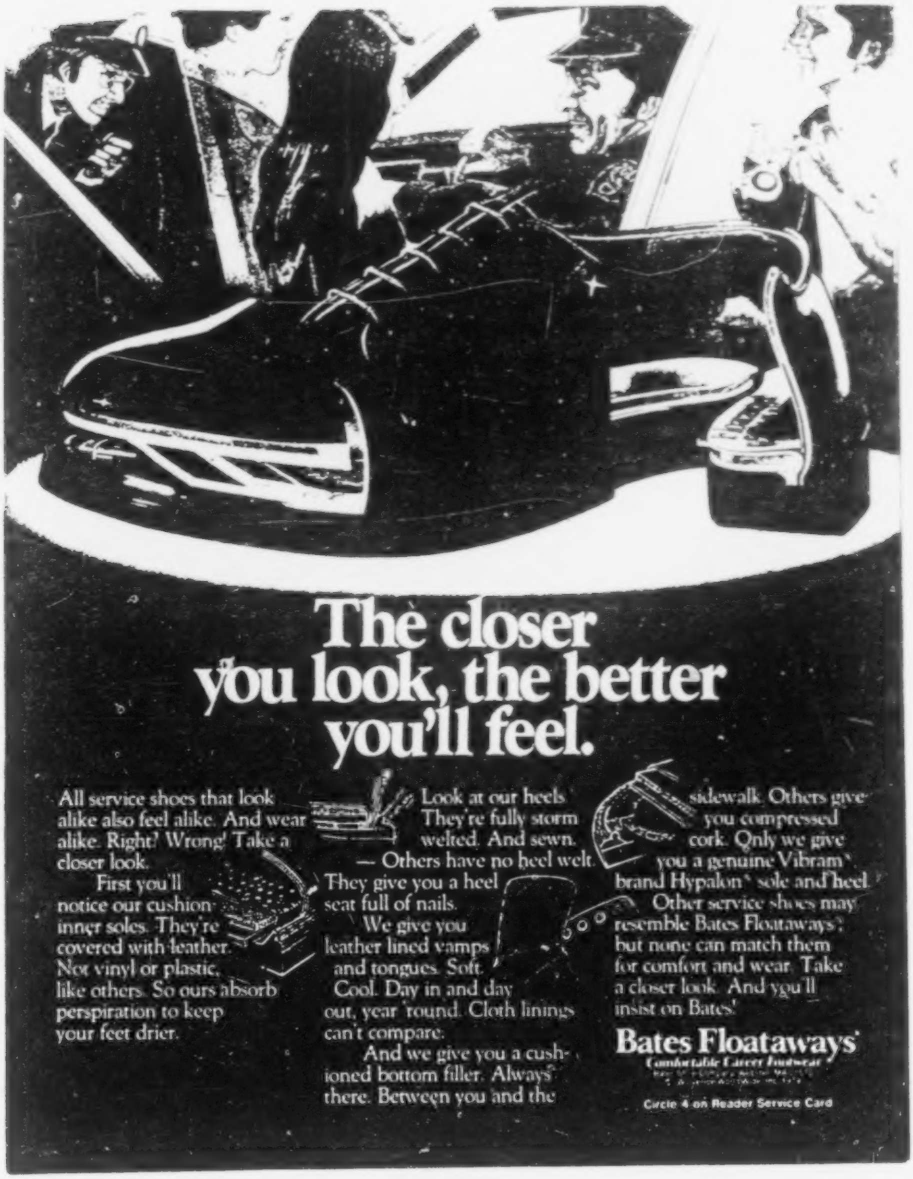
GENERAL DUTY S-1618



TACTICAL DUTY S-1610

Circle 31 on Reader Service Card

EX. E



The closer you look, the better you'll feel.

All service shoes that look alike also feel alike. And wear alike. Right? Wrong! Take a closer look.

First you'll notice our cushion inner soles. They're covered with leather. Not vinyl or plastic, like others. So ours absorb perspiration to keep your feet drier.

Look at our heels. They're fully storm welted. And sewn. — Others have no heel welt. They give you a heel seat full of nails.

We give you leather lined vamps and tongues. Soft. Cool. Day in and day out, year 'round. Cloth linings can't compare.

And we give you a cushioned bottom filler. Always there. Between you and the sidewalk. Others give you compressed cork. Only we give you a genuine Vibram* brand Hypalon* sole and heel.

Other service shoes may resemble Bates Floataways*, but none can match them for comfort and wear. Take a closer look. And you'll insist on Bates!

Bates Floataways*

Comfortable Career Footwear

Circle 4 on Reader Service Card

SHOULD YOUR PUBLIC IMAGE
BE RIDING ON FOREIGN MOTORCYCLES?

We think not.

But we are not asking you to simply 'Buy American'. We feel our police motorcycles stand head and shoulders above any other regardless of country of origin.

Though our heritage is colorful, our revolutionary FLHT, our belt-drive FLH and our FLH Police Special are far superior to any motorcycles we have offered in the past. Yet we still hold the belief that simplicity of design is the only way to assure dependable, cost efficient performance.

We don't think your public image should be riding on foreign motorcycles. Once given the opportunity to present our motorcycles in detail, we doubt that the issue will ever arise.

Please allow us to send you our complete brochure. Write: Dick Reiter, Harley-Davidson Motor Co. Inc., P.O. Box 653, Milwaukee, WI 53201. Or call: 414-935-4411.

MOTORCYCLES. BY THE PEOPLE. FOR THE PEOPLE.™

© 1982 Harley-Davidson Motor Company, Inc. All rights reserved

Circle 2 on Reader Service Card

cess which is given the least attention by most law enforcement administrators since the concept of analysis is least understood.[2] In New Jersey, the opposite approach was taken, and demands were placed on this component that eventually upgraded the quality of the intelligence assessments. This required some radical departures from traditional law enforcement practices.

First, in order to formalize and delineate the operations of the bureau, the analytical unit was tasked with the responsibility of developing a bureau manual. Heretofore such an approach to managing an intelligence unit was unheard of. Intelligence activities were to be secret, erroneously connoting an image that what the police were doing was either illegal or immoral. This belief was quickly dispelled in that, prior to promulgation, the manual was reviewed by the American Civil Liberties Union and subsequently released for public consumption. This manual has served as the basis for procedural guidelines in a number of American and foreign law enforcement agencies.[3]

The next radical departure from tradition was the use of a professional contingent of civilian analysts—female and male—in the operations of the bureau. Inasmuch as intelligence administrators are supersensitive to "outsiders" being afforded an entry into their "deep-dark secrets," there was a natural and understandable resistance to integrating civilians and particularly females into the structure of the bureau. However, the institutional support received from management, coupled with the establishment of minimum educational requirements (a four-year baccalaureate degree is required), commensurate salaries, and the adoption of professionally rigorous standards, methods, and techniques did much to minimize the benign yet pervasive suspicions that existed.[4]

Having established in very short order a viable and serious analysis component, it was necessary to develop programs and systems which would refine the intelligence process. Working in cooperation with the division of systems and communications, computer programs were developed which automated many of the time-consuming manual methods of analysis. In particular, we were able to acquire a software package (referred to as OCAP—Organized Crime Analysis Program) which provided the analysts with the most sophisticated analytical routines on the market.[5] We developed a telephone toll analysis program (TAP) which allows for such unique features as commonality and communicative network analysis, linear time analysis, and sequential ordering.[6] Needless to say, these packages have reduced significantly the antiquated manual methods which were used in the past.

The remaining program provides an instant retrieval and collation capability, but, more importantly, an analytical capacity. The Computerized Intelligence Analysis System (CIAS) integrates routines that permit analysts to conduct independent research in a cost-effective manner.[7] For example, with this system, we are able to assemble expeditiously all the available data on organized crime violence in a particular geographic location involving members of a specific criminal network. This

---

[4] For a copy of this material, contact New Jersey State Police Analytical Unit, Box 7068, West Trenton, NJ 08628.

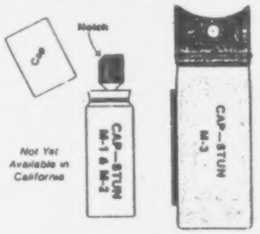
[5] Douglas Harris and Lester Ford, Organized Crime Analysis Program (Santa Barbara, CA: General Research Corporation, August 1976).

[6] Division of Systems and Communications, [illegible], West Trenton, NJ.

[7] Ibid.

Instantly Disables All Subjects for Up to 30 Minutes.

DESIGNED FOR SECURITY AND LAW ENFORCEMENT USE.



CAP—STUN

The Instantly Effective Non-Lethal Weapons

All new spray, not mace or tear gas. Designed to disable all subjects up to 30 minutes, including drunks, psychotics, drug abusers and attack dogs. No area contamination. No harmful effects. CAP—STUN M-4 fits uniform holsters. Effects removed in five or less minutes with clear water. Treatment not needed. Protective caps and pocket clips for M-1 & M-2. Velcro strip on M-3 for handy use in car, van, as well as under desk or counter. M-1 replaces Nebulizer XL-4 canister. All models have positive "Feel" for night use. No aiming problem. Available at gun dealers and police supplies.

Call (614) 875-8333 or write for further information and introductory pricing.

LUCKEY POLICE PRODUCTS

P.O. Box 28142 • Columbus, Ohio 43228

NEW

Methaqualone Reagent

(QUAALUDES)

- Super sensitive . . . no need for large sample.
- Eliminate 28 respond-alikes in one step.
- Same unit price as all our reagents.

From the manufacturer of NARCOTEST DISPOSAKIT

ODV

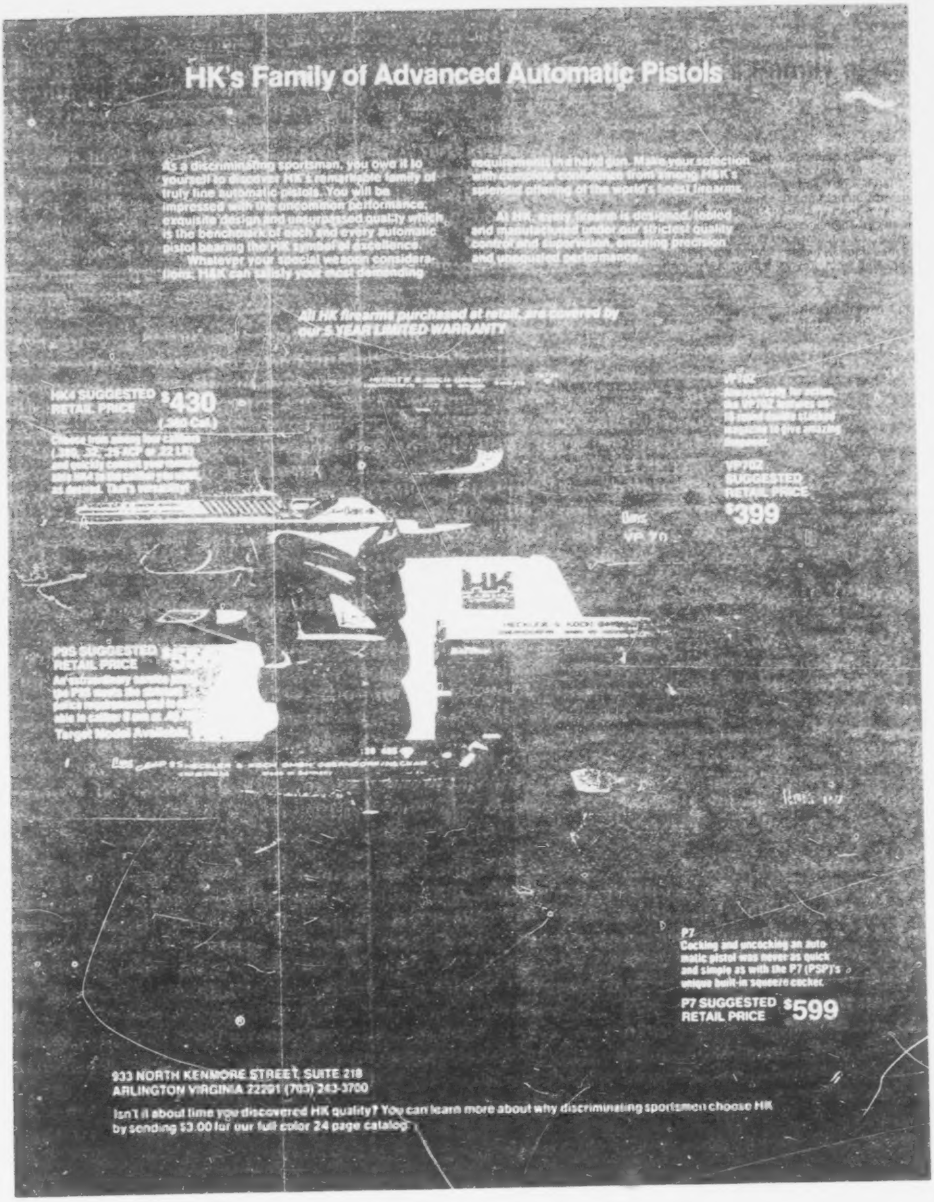
First and Foremost in Narcotic Identification

INCORPORATED

P.O. Box 305 A South Paris, ME 04281

Write or call for additional information (207) 743 7712

EX. F



HK's Family of Advanced Automatic Pistols

As a discriminating sportsman, you owe it to yourself to discover HK's remarkable family of truly fine automatic pistols. You will be impressed with the uncommon performance, exquisite design and unsurpassed quality which is the benchmark of each and every automatic pistol bearing the HK symbol of excellence.

Whatever your special weapon considerations, H&K can satisfy your most demanding requirements in a hand gun. Make your selection with complete confidence from among H&K's splendid offering of the world's finest firearms.

At HK, every firearm is designed, tooled and manufactured under our strictest quality control and supervision, ensuring precision and unequaled performance.

All HK firearms purchased at retail, are covered by our 5 YEAR LIMITED WARRANTY

HK4 SUGGESTED RETAIL PRICE $430 (.380 Cal.)

Choose from among four calibers (.380, .32, .25 ACP or .22 LR) and quickly convert your [illegible] HK4 to the caliber [illegible] as desired. That's versatility!

VP70Z

[illegible] for action, the VP70Z features an 18-round double stacked magazine to give amazing firepower.

VP70Z SUGGESTED RETAIL PRICE $399

P9S SUGGESTED RETAIL PRICE [illegible]

An extraordinary [illegible] the P9S meets the [illegible] police requirements and [illegible] able in caliber 9 mm or .45. Target Model Available.

P7

Cocking and uncocking an automatic pistol was never as quick and simple as with the P7 (PSP)'s unique built-in squeeze cocker.

P7 SUGGESTED RETAIL PRICE $599

933 NORTH KENMORE STREET, SUITE 218
ARLINGTON VIRGINIA 22201 (703) 243-3700

Isn't it about time you discovered HK quality? You can learn more about why discriminating sportsmen choose HK by sending $3.00 for our full color 24 page catalog.

of them was a playboy, the other was a plain and simple boy. If they'd had their way, we'd have a welfare state the likes of which FDR never dreamed of. They wouldn't have stopped until they had everyone on the dole. This country will bear the stamp of their mismanagement for a century to come."

For a long second he paused as if waiting for a reply, and I got the impression Murphy was about to challenge him when he suddenly terminated the lecture. He rose from his chair and walked around to face us. He thrust out his hand and a few seconds later waved us over to the agent who had brought us in, who had mysteriously reappeared.

Hoover smiled a farewell. It was a downward smile, and from childhood on I had distrusted those. Outside of J. Edgar, the most frightening downward smile I had ever seen belonged to Leslie Fenton, the late silent movie villain, whose lips turned downward into a death grin even as Edward G. Robinson sank an axe into his skull.

As the agent led us back to the reception room, I could not repress a "Wow!" Murphy caught my coat, then put a finger to his mouth. We left in a hurry, rushing past the seven floors of bronze heads, grateful to get out into the clear outside air.

Away from the building, Murphy said: "Okay, you can sound off now. I wasn't sure whether the walls were bugged. What have you got to say?"

"What have I got to say? Christ! Do you realize we were talking to the most powerful man in America? Do you realize he's psycho? What a story this would make!"

"Maybe, but you're not going to tell it. Nobody would believe you, anyway."

"Okay. For now. But I will someday. What'd you think about the session?"

Murphy grinned. "Well, if he goes around calling Parker an alcoholic, I wonder what he tells people about me?" Then he added, "I can do with a drink or two. How about you?"

Somewhat calmer, I nodded, and we spent the rest of the afternoon getting our perspective back. ☐

DAMART THERMOLACTYL

LAUGH at the COLD!

It's 10° outside . . . Even getting colder. So you bundle up in layers and layers of heavy clothes. First with long underwear . . . then bulky, restrictive thermalwear on top.

Oh, you were warm all right. Like in a Turkish bath. Because you began to perspire from all your activity. And perspiring in that mountain of clothes is like perspiring in a plastic bag! The perspiration is locked in. So there you are. Wet and miserable.

But now, at last, Damart has solved the problem. Because Damart invented underwear that keeps you *warm, dry and comfortable* no matter how cold it is or how long you stay out. Underwear that's soft and light so you can move easily. Underwear knitted to let the *perspiration evaporate through* so you always stay warm and dry next to your skin. Nothing else does this like Damart.

Damart does this with a new miracle fabric—Thermolactyl. You can wear Damart indoors too, and turn your thermostat down into the 60's. You'll feel perfectly comfortable and enjoy dramatic savings in home heating costs.

Damart is so comfortable that the Mt. Everest climbing expedition wears it. So do the Pittsburgh Steelers, Buffalo Bills, New York Jets and Philadelphia Eagles Football Clubs.

Our free color catalog tells the full Damart Thermolactyl story and displays the whole Damart line for men and women, *including tall sizes*. Send for your FREE copy now!

THE PROOF IS IN THE WEARING!

Damart Thermolactyl

When in the Boston area, visit our Portsmouth, N.H. Store (603) 431-4700

THERE IS NO WARMER UNDERWEAR MADE!

Fill out and send to:
DAMART, Dept. 10082
1811 Woodbury Ave.
Portsmouth, N.H. 03805

YES! Rush me your FREE DAMART Catalog . . . I want to enjoy the fantastic warmth of Thermolactyl Underwear, a DAMART® exclusive. (I understand there is no obligation.)

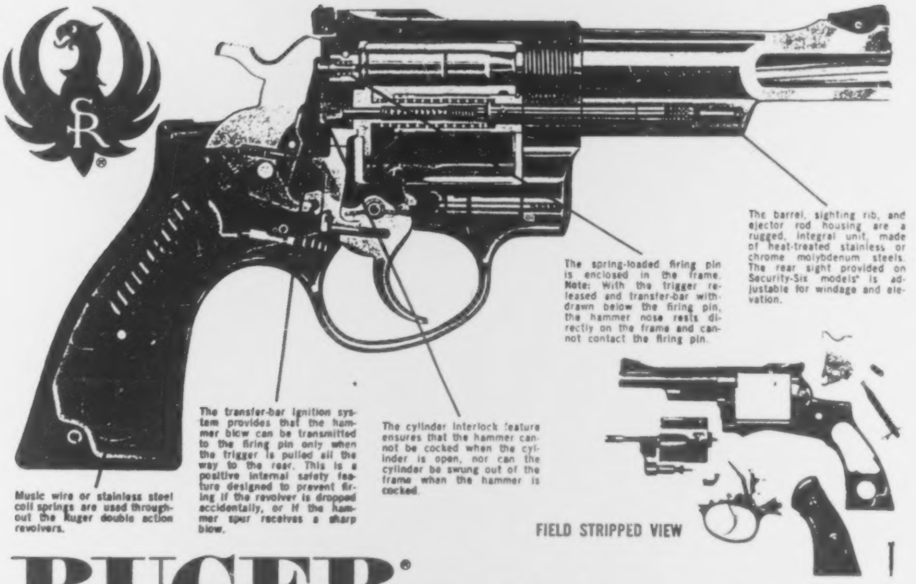
PRINT NAME

ADDRESS

CITY STATE ZIP © 1982, Damart

Circle Reader Service 106

EX. G



Music wire or stainless steel coil springs are used throughout the Ruger double action revolvers.
The transfer-bar ignition system provides that the hammer blow can be transmitted to the firing pin only when the trigger is pulled all the way to the rear. This is a positive internal safety feature designed to prevent firing if the revolver is dropped accidentally, or if the hammer spur receives a sharp blow.
The cylinder interlock feature ensures that the hammer cannot be cocked when the cylinder is open, nor can the cylinder be swung out of the frame when the hammer is cocked.
The spring-loaded firing pin is enclosed in the frame. Note: With the trigger released and transfer-bar withdrawn below the firing pin, the hammer nose rests directly on the frame and cannot contact the firing pin.
The barrel, sighting rib, and ejector rod housing are a rugged, integral unit, made of heat-treated stainless or chrome molybdenum steels. The rear sight provided on Security-Six models* is adjustable for windage and elevation.
FIELD STRIPPED VIEW

RUGER® Double Action Revolvers

These are the revolvers created by Ruger engineers who started with a fresh sheet of paper and an unlimited budget! There is nothing in the design of these Ruger double action revolvers which is there simply because "it has always been done that way"; nothing which reflects a commitment to outmoded production methods or obsolescent factory facilities. Representing a significant improvement in design, these revolvers incorporate creative Ruger engineering, sophisticated manufacturing techniques, and superior materials.

The Ruger design philosophy of strength, simplicity, and ease of maintenance has been applied throughout the design of these revolvers. Composed of a series of integrated subassemblies, the Ruger double action revolver can be field stripped to its basic components in seconds, without the use of tools. The entire lock mechanism is installed through the bottom of the grip frame as a unit, permitting the use of solid frame side-walls which contribute to the great strength of these revolvers. The complex milled-out frames and delicately fitted sideplates of other double action revolvers, and the difficulties of maintenance and weaknesses inherent in older designs are eliminated entirely.

The finest materials are used in Ruger double action revolvers. Music wire or stainless steel coil springs are used throughout and frames, cranes, cylinders, and barrels are of heat-treated stainless or chrome molybdenum steels. Most of the small internal parts of *all* models of Ruger double action revolvers are made of stainless steel.

In addition to traditional Ruger quality and dependable performance, the shooter enjoys the advantages of the durable stainless steel mechanism parts,* even in standard blued models.

Ruger Security-Six Revolver in 357 Magnum caliber with rear sight adjustable for windage and elevation. Choice of 2¾", 4", or 6" barrel in blued finish or stainless steel.

Ruger Police Service-Six Revolver in 357 Magnum, 38 Special, and 9 mm parabellum (blued model only) calibers with fixed sights. Choice of 2¾" or 4" barrel in blued finish or stainless steel.

Ruger Speed-Six Revolver with compact round butt in 357 Magnum, 38 Special, and 9 mm parabellum (blued model only) calibers with fixed sights. Choice of 2¾" or 4" barrel in blued finish or stainless steel.

RUGER, Security-Six, Service-Six, and Speed-Six are registered U. S. trademarks

FOR YOUR COPY OF A FREE ILLUSTRATED CATALOG OF ALL RUGER FIREARMS, WRITE DEPT. PM

STURM, RUGER & Company, Inc.
Southport, Connecticut 06490 U.S.A.

ALL RUGER FIREARMS ARE DESIGNED AND MANUFACTURED IN RUGER FACTORIES IN THE UNITED STATES OF AMERICA

Circle Reader Service 114

Chairman PICKLE. Thank you, Mr. Lumerman.

Now, Mr. Hodges, if you will proceed.

STATEMENT OF HORACE W. HODGES, IMMEDIATE PAST PRESIDENT, FRATERNAL ORDER OF POLICE, STATE LODGE OF ALABAMA

Mr. HODGES. Thank you, Mr. Chairman.

Let me preface my remarks by saying I certainly appreciate the invitation to be here.

My name is Horace W. Hodges, and I am a member in good standing and the immediate past president of the Alabama State Lodge of the Fraternal Order of Police. I served as president during our fiscal year which ended in 1985, the first year for which unrelated business taxable income [UBIT] has ever been charged against the Alabama lodge. We have been informed by the examining agent that similar adjustments are forthcoming for our fiscal years which ended in 1986 and 1987.

I understand that Chairman Pickle has requested that certain points be addressed. First, what types of income-producing activities are generating our UBIT? My response is that the examining agent states our magazine income is UBIT because it results from the sale of advertising; since we are now engaged in negotiations on that issue, I cannot acknowledge and do not necessarily agree that the Alabama lodge is indeed receiving UBIT. Excerpts from our quarterly magazine, the Alabama Police Journal, appear in our written statement.

Second, what is the extent of our UBIT, and how much tax is due? Again, without agreeing that we have any UBIT, the IRS is saying that we had some $79,000 of UBIT in 1985, with $20,200 tax due, and $121,392 of UBIT in 1986, with tax estimated to be in excess of $30,000; 1987 has not been tabulated, but similar results are expected with an estimated tax bill of $80,000 due and payable.

Finally, what are our major sources of income excluded or exempted from UBIT characterization? The point is of crucial importance to my testimony, and the figures speak for themselves. In 1985, only 33 percent of our total income was from other sources. This includes dues, public support, interest income, and a few miscellaneous activities. In 1986, only 20 percent of our income came from exempt sources. Similar figures are expected for 1987. Thus, you can see that the overwhelming majority of our operating capital originates from periodical revenues.

In the time I have remaining, I would like to urge each member of the committee to take a few moments and read our written statement and carefully review the exhibits attached. I believe you will see that the Alabama lodge is not in the advertising business. On the contrary, we are working for the betterment of society as a whole through the improvement of the quality of laws and that of law enforcement. The Alabama Police Journal is simply a vehicle for communication with our membership and a convenient and efficient means of enabling businesses and individuals to support us with donations.

I am here to ask for your assistance in the drafting and enactment of curative legislation in this area. Without your help, the

Alabama lodge and hundreds of other exempt organizations will cease to exist in any viable capacity.

Thank you.

[The prepared statement follows:]

June 29, 1987

Subcommittee on Oversight
1105 Longworth Building
Washington, D.C. 20515

RE: Hearings on Unrelated Business Taxable Income;

STATEMENT OF FRATERNAL ORDER OF POLICE, STATE LODGE OF ALABAMA

I. INTRODUCTION

An emergency is facing the Alabama State Lodge of the Fraternal Order of Police. The Internal Revenue Service has recently informed us that the source of the great majority of our operating funds, our quarterly magazine entitled Alabama Police Journal, is in fact producing taxable income. As a result, we find ourselves on the horns of a dilemma. First, how do we pay the estimated $80,000.00 in unforeseen taxes and still function as a viable organization? Second, how can we hope to plan or continue future operations if crippled by large annual tax burdens?

The crux of our problem is the characterization by the Service of our advertising revenues as "unrelated business taxable income" as such term is defined by the Internal Revenue Code, Treasury Regulations, Revenue Rulings, case law and lesser authorities (hereinafter referred to as UBTI). According to the Service, we received substantial amounts of UBTI during our fiscal years which ended (FYE) in 1985, 1986 and 1987. At present, we are negotiating with the Examination Division only with respect to FYE 1985 and 1986, as our return is not yet due or filed for FYE 1987; however, we have been informed that the posture of the Service will be the same for this and future years.

Frankly, we do not have the funds to pay these taxes and continue serving the purposes for which we were granted a tax exemption thirty-five years ago. If we nevertheless are compelled to do so, the Alabama State Lodge of the Fraternal Order of Police, which has been in continuous existence since 1947, will be forced to dissolve. We do not believe that the policies behind current law making are being served by the systematic bankrupting of exempt organizations such as ours; however, that is the practical extension of the current campaign of the Internal Revenue Service. We implore you and your colleagues in the Congress to enact remedial legislation as soon as possible.

II. ACTIVITIES OF THE ALABAMA STATE LODGE

It is important to note that our organization is a very active one whose beneficiaries include those both within and without the law enforcement community. Our Constitution provides, in pertinent part, as follows:

> Article II
> Aims and Objects
>
> Section 1. This organization is formed for the bettering of the existing conditions for the police of the State of Alabama.
>
> Section 2. The Alabama State Lodge of the Fraternal Order of Police is an organization of police sworn to enforce the

laws impartially under all circumstances, and has no other affiliation.

Section 3. The aims of this organization are:

A. The advancement of social, charitable and educational undertakings among the police of the State.

B. A national uniform traffic law.

C. A state-wide civil service law and its rigid enforcement.

D. The establishment of a Police Pension Fund for all Cities, Counties, Boroughs, Towns and Townships in the State.

E. To take cognizance of all matters of state-wide and local concern affecting the welfare and interests of Policemen and their dependents. The Executive Board shall take such immediate action as shall be necessary to safeguard their welfare or interest by providing aid and such other legal or technical advisory services as shall be appropriate.

In furtherance of these objectives, the Alabama State Lodge, through various committees, undertakes numerous activities each year which improve the lives of our members, their families, law enforcement personnel in general and the people of the State of Alabama at large.

The Legislative Committee monitors all bills which could have an effect on the quality of law enforcement and acts as liaison between our members and the State Legislature. We do not employ professional lobbyists. In past years, we have been instrumental in the enactment of state laws which (1) established minimum standards of competency for police officers; (2) provided for the payment of college expenses for the children of officers killed in the line of duty; (3) set up a fund from which the surviving spouse of any police officer killed in the line of duty is paid a death benefit of $10,000.00; and (4) amended the same to provide for a death benefit of $20,000.00 for such a surviving spouse (we worked alongside other state lodges in supporting the passage of Federal legislation providing for a death benefit of $50,000.00 for such a surviving spouse).

The Boys' Camp Exchange Committee arranges for the contribution of $10,000.00 to $15,000.00 each year toward the administration of a summer camp for underprivileged children. The camp, located in Montgomery County, Alabama affords these young people the opportunity to live and play in a clean, healthy and enjoyable environment for one week each year. Last year, the Alabama Lodge paid fully one-half of the camp expenses.

The Honor Guard Committee, consisting of sixteen members statewide, is continuously on call for funerals of any and all law enforcement officials, whether killed in the line of duty or dying from any cause. This group is also available for parades and other ceremonies which require a color guard.

The Easter Seals Committee collects contributions within the organization. Each year these funds are donated to the Easter Seals Campaign.

The Memorial Fund Committee allocates funds to worthwhile projects which commemorate all law enforcement officers killed in the line of duty in the State of Alabama. On May 8, 1987 a memorial monument was dedicated on the South lawn of the State Capitol building in Montgomery, Alabama. This impressive statue, resting on an engraved pedestal, depicts an officer retrieving the uniform cap of a slain comrade. The Alabama Lodge Memorial Fund and other Alabama law enforcement officers joined together to pay for the monument.

The Member of the Year Committee selects a worthy recipient of this award each year. The honoree is recognized as such both at public ceremonies and in our quarterly magazine. Our organization provides for an honorarium in the form of a new uniform or other similar gift for the Member of the Year in recognition of his service and efforts toward the improvement of the quality of law enforcement.

The Magazine Committee meets on a regular basis to review the contents of the Alabama Police Journal and to supervise the editorial content, format and operations thereof. The Committee makes recommendations for the improvement of the magazine. The objective of the Magazine Committee is to produce a publication which will keep our members up to date on developments in the law and within the organization and also to recognize meritorious service of our members and any awards or accolades they have received.

In addition to the above referenced committee activities, our organization maintains a legal defense fund, which is available to all members of the Alabama Lodge in times of need. We also maintain a Memorial Fund Scholarship in the amount of $14,000.00, which is used to defray the costs of college education of a selected child of a member of the Alabama Lodge.

The remainder of funds not used for the above referenced activities are needed to support the administration of our organization, as follows:

1. Annual board meeting--Reimburse transportation, lodging and related expenses of seventy-six state officers.

2. Annual state conference--Reimburse all state officers for transportation, lodging and related expenses.

3. Secretary/Treasurer--Salary of $2,000.00 per year.

4. Executive Director--This position was created within the past year; salary of $1,000.00 per month plus expenses.

5. Montgomery office--Maintenance of office space.

6. State President--President is furnished with automobile and reimbursed for maintenance expenses thereof.

7. National Police Memorial Services--This conference is held in May of each year in Washington, D.C. The Alabama Lodge pays transportation, lodging and related expenses for the President, Vice President, Secretary/Treasurer and two other members.

Membership in our organization is available to any full-time active law enforcement officer employed by any governmental entity as a police officer with power of arrest. Local lodges are allowed to have associate, i.e., non-police officer, members. There are sixty-seven subordinate lodges contained within the Alabama Lodge. At present, we have between five and six thousand members.

Local or subordinate lodges are assessed dues on a per capita basis at $1.00 semi-annually per member. The national lodge assesses the Alabama lodge on a per capita basis at $1.50 semi-annually per member. Thus, total dues of each member of the state lodge amount to $5.00 per year.

III. NEED FOR LEGISLATIVE RELIEF

The United States Supreme Court, in the recent case United States vs. American College of Physicians, 475 U.S. ____ (1986), reversed the ruling of the Federal Circuit and held that a tax exempt medical organization was liable for taxes on unrelated business income from advertising proceeds because the advertisements were not substantially related to its tax exempt purposes. It is interesting to note that Chief Justice Burger filed a concurring opinion in that case in which he stated, in pertinent part:

> Most medical journals are not comparable to magazines and newspapers published for profit. Their purpose is to assemble and disseminate to the profession relevant information bearing on patient care. . . . In a sense these journals provide continuing education for physicians--a "correspondence course" not sponsored for profit but public health. . . . There is a public value in the widest possible circulation of such data, and advertising surely tends to reduce the cost of publication and hence the cost to each subscriber, thereby enhancing the prospect of wider circulation. Plainly a regulation recognizing these realities would be appropriate. Such regulations, of course, are for the Executive Branch and the Congress, not the courts (Emphasis supplied).

We would echo the sentiments of the Chief Justice and call upon you to draft and pass curative legislation with respect to UBTI. Our organization is neither equipped nor able to conduct what may be viewed as traditional fund raising projects. We rely and depend almost exclusively upon the revenues received from the publication of the Alabama Police Journal for our operating capital. Since its inception in 1967, we have utilized the magazine both as a conduit for the dissemination of information to our members and other subscribers, and as a source of funds for our various activities as outlined above. We have done so in good faith and, until just a few months ago, were not aware that advertising revenues could be characterized as UBTI. If we had been so aware, we would have brought this statement to you long before now.

Attached hereto and incorporated herein by reference are exhibits A, B, C, D and E, which are photocopies of printed material contained in the Alabama Police Journal, Vol. 23, Number 4 (Winter, 1987). These items typify the content of the non-editorial portion of our magazine; it is due to these items being characterized as "advertisements" that we are now being subjected to income tax on UBTI. As our brethren from the Illinois State Troopers Lodge will have told you before these hearings are concluded, the merits of a case such as ours have apparently fallen on deaf ears in the United States Tax Court (See Fraternal Order of Police, Illnois State Troopers Lodge No. 41 vs. Commissioner, 87 TC ____ (1986), now on appeal to the United States Court of Appeals for the Seventh Circuit).

As you may have surmised, and as we vigorously argue, though some items published in the Alabama Police Journal, may resemble commercial advertising, they are there for one primary reason: the businesses, individuals or organizations named in the items have made donations supporting our organization and we, in appreciation of such donations, publish the names and addresses of the donors and, in some instances, other information regarding the business activities or other pertinent information with respect to such donors.

Before the enactment of the Revenue Act of 1950 (Ch. 994, 64 Stat. 906 (1950 Act)), the law required only that profits received by exempt organizations be used in furtherance of the tax-exempt purposes of those organizations, and without regard to the source of those profits. (See Trinidad vs. Sagrada Orden de Predicadores, 263 U.S. 578, 581 (1924); C. F. Mueller Co. vs. Commissioner, 190 F.2d 120 (3rd Cir. 1951); Roche's Beach, Inc. vs. Commissioner, 96 F.2d 776 (2nd Cir. 1938). Beginning in 1950, however, Congress required that a trade or business activity be substantially related to the exempt purposes of the organization in order to be exempt from UBTI taxation. As we understand the law, if our local lodges sponsored qualified bingo sessions which produced these revenues, the same would not be characterized as UBTI. The same result would obtain in the event our members trudged door-to-door in solicitation of contributions, or if we held "auctions" for donated items. We do not see why our magazine revenues are tainted as UBTI while these escape.

For the Service, the Treasury Department and the Federal court system, under the banner of revenue collection, to penalize the beneficent activities of exempt organizations such as ours by taxing these revenues is a misguided endeavor. We believe that there must be a way to allow our organization and others like it to carry on as we have in the past without having to fear the assessment of tax deficiencies every time we embark on an activity to raise funds. It is for these reasons we ask this Subcommittee to conduct a thorough review of this area of the Internal Revenue Code and to enact legislation which will either exempt our magazine revenues from taxation or provide us with allowable deductions to offset the same.

IV. CONSEQUENCES OF LEGISLATIVE ABSTENTION

If the Congress does not respond to our request for statutory relief, our organization, in an effort to pay the unexpected new taxes, will be forced to cancel all operations which require the distribution of funds. The worthwhile and charitable activities discussed in Section II, above, will be suspended due to lack of funds. The very existence of our organization will be in peril, as there will not be enough capital on hand each year even to support the administration of our organization, much less the carrying out of the various scholarships, memorial funds and other projects.

If the objective of the UBTI assessment and collection actions of the Service is to generate and produce revenue, we feel that such would be of a very limited benefit to the national fisc. There may be a short term windfall produced by the payment of assessments, collection of deficiencies and/or levy of property now owned by exempt organizations. However, within a very short time, the taxpayer organizations will be forced out of existence. Thus, in exchange for a quick fix in the form of revenue collection, our organization and untold numbers like it will not be around to serve their members and the public at large in the ways we are now doing. We simply cannot believe that this is the result intended by Congress for the implementation of the provisions of the Internal Revenue Code, and we respectfully implore you to assist us and other exempt organizations in the resolution of this crisis.

a/552

SH BY MEDICAL
 ENTER
rtners for Life
663-5770, ALABASTER

H.C.MOORE
and SON

683-6363
Washington Street

MARION

Y DRUG COMPANY

833 Quintard Avenue
ANNISTON

Ric rd Wilson
and
A ociates

17 Mildred Street
Montgomery
264-6433

Alabama
Oil Company

Division of
Spencer
Company,
Inc.

Huntsville

533-1150

Ame an Legion

P #155
UM

ROSE TRUCK
BROKERS, INC.

Spuds Haulers and Shippers
Seasonal Offices
Henager, AL 205-657-3226
Almond, WI 715/366-4444
940/325-7512
1-800-847-8871 Out-of State WATS

M & N
A o Service
Mobile

649-4045

Wh - Spunner & Associates, Inc.

WHITE-SP
&
ASSOCIATE

3201 Dauphin Street
MOBILE
476-6000

Ma Fronts

699-2471
429 Miami Avenue
Leeds

Compliments of
CON-AGRA, Inc.

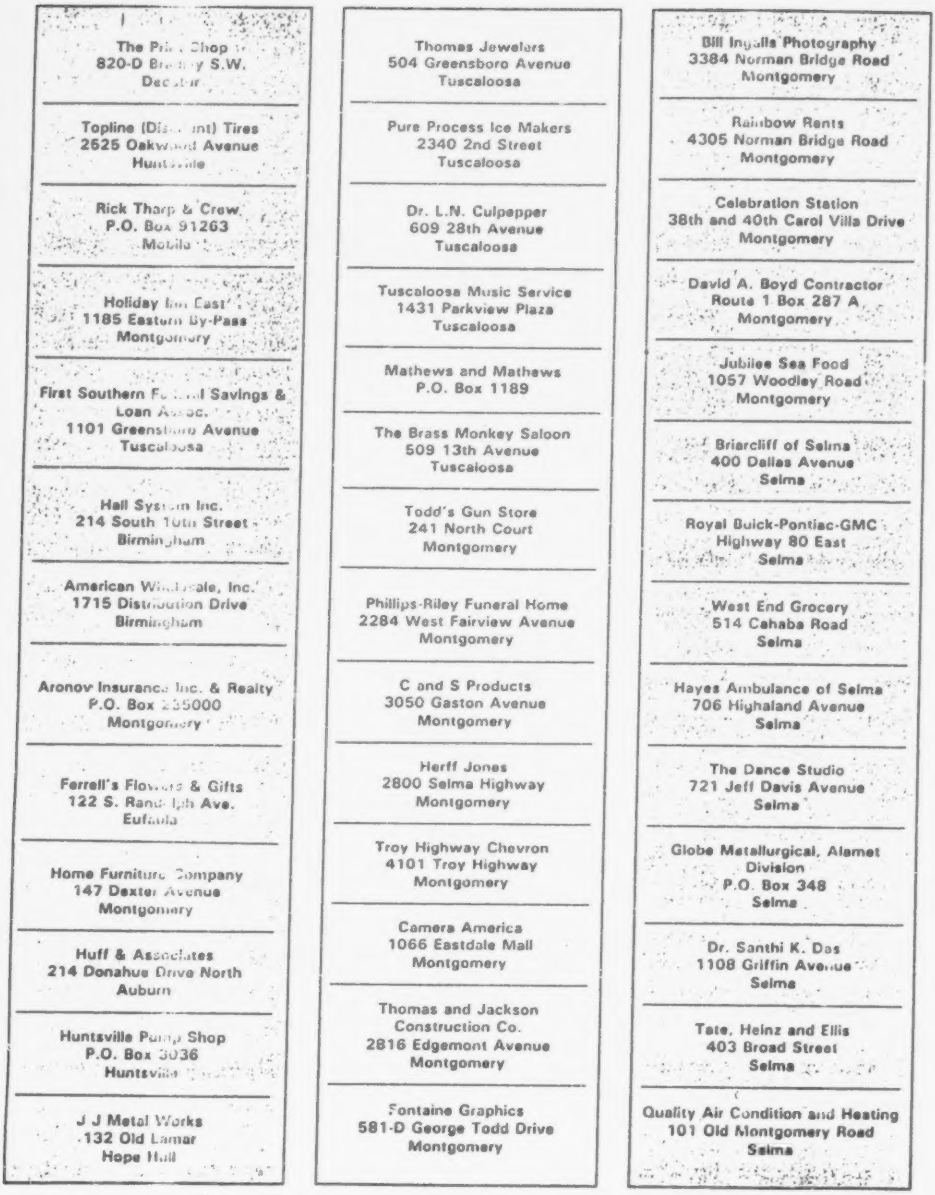
2050 Market Street
North East

DECATUR
552-4650

JOY YOUNG RESTAURANT
BROOKWOOD GALLERY
BIRMINGHAM
SEAFOOD & STEAKS, CLOSED MONDAY —
OUT AVAILABLE
879-7500

Winter, 1987/51

EXHIBIT A
to
Statement of Fraternal Order of Police
State Lodge of Alabama
Before the Subcommittee on Oversight



The Print Shop
820-D Bradley S.W.
Decatur

Topline (Discount) Tires
2625 Oakwood Avenue
Huntsville

Rick Tharp & Crew
P.O. Box 91263
Mobile

Holiday Inn East
1185 Eastern By-Pass
Montgomery

First Southern Federal Savings & Loan Assoc.
1101 Greensboro Avenue
Tuscaloosa

Hall System Inc.
214 South 10th Street
Birmingham

American Wholesale, Inc.
1715 Distribution Drive
Birmingham

Aronov Insurance Inc. & Realty
P.O. Box 235000
Montgomery

Ferrell's Flowers & Gifts
122 S. Randolph Ave.
Eufaula

Home Furniture Company
147 Dexter Avenue
Montgomery

Huff & Associates
214 Donahue Drive North
Auburn

Huntsville Pump Shop
P.O. Box 3036
Huntsville

J J Metal Works
132 Old Lamar
Hope Hull

Thomas Jewelers
504 Greensboro Avenue
Tuscaloosa

Pure Process Ice Makers
2340 2nd Street
Tuscaloosa

Dr. L.N. Culpepper
609 28th Avenue
Tuscaloosa

Tuscaloosa Music Service
1431 Parkview Plaza
Tuscaloosa

Mathews and Mathews
P.O. Box 1189

The Brass Monkey Saloon
509 13th Avenue
Tuscaloosa

Todd's Gun Store
241 North Court
Montgomery

Phillips-Riley Funeral Home
2284 West Fairview Avenue
Montgomery

C and S Products
3050 Gaston Avenue
Montgomery

Herff Jones
2800 Selma Highway
Montgomery

Troy Highway Chevron
4101 Troy Highway
Montgomery

Camera America
1066 Eastdale Mall
Montgomery

Thomas and Jackson Construction Co.
2816 Edgemont Avenue
Montgomery

Fontaine Graphics
581-D George Todd Drive
Montgomery

Bill Ingalls Photography
3384 Norman Bridge Road
Montgomery

Rainbow Rents
4305 Norman Bridge Road
Montgomery

Celebration Station
38th and 40th Carol Villa Drive
Montgomery

David A. Boyd Contractor
Route 1 Box 287 A
Montgomery

Jubilee Sea Food
1057 Woodley Road
Montgomery

Briarcliff of Selma
400 Dallas Avenue
Selma

Royal Buick-Pontiac-GMC
Highway 80 East
Selma

West End Grocery
514 Cahaba Road
Selma

Hayes Ambulance of Selma
706 Highaland Avenue
Selma

The Dance Studio
721 Jeff Davis Avenue
Selma

Globe Metallurgical, Alamet Division
P.O. Box 348
Selma

Dr. Santhi K. Das
1108 Griffin Avenue
Selma

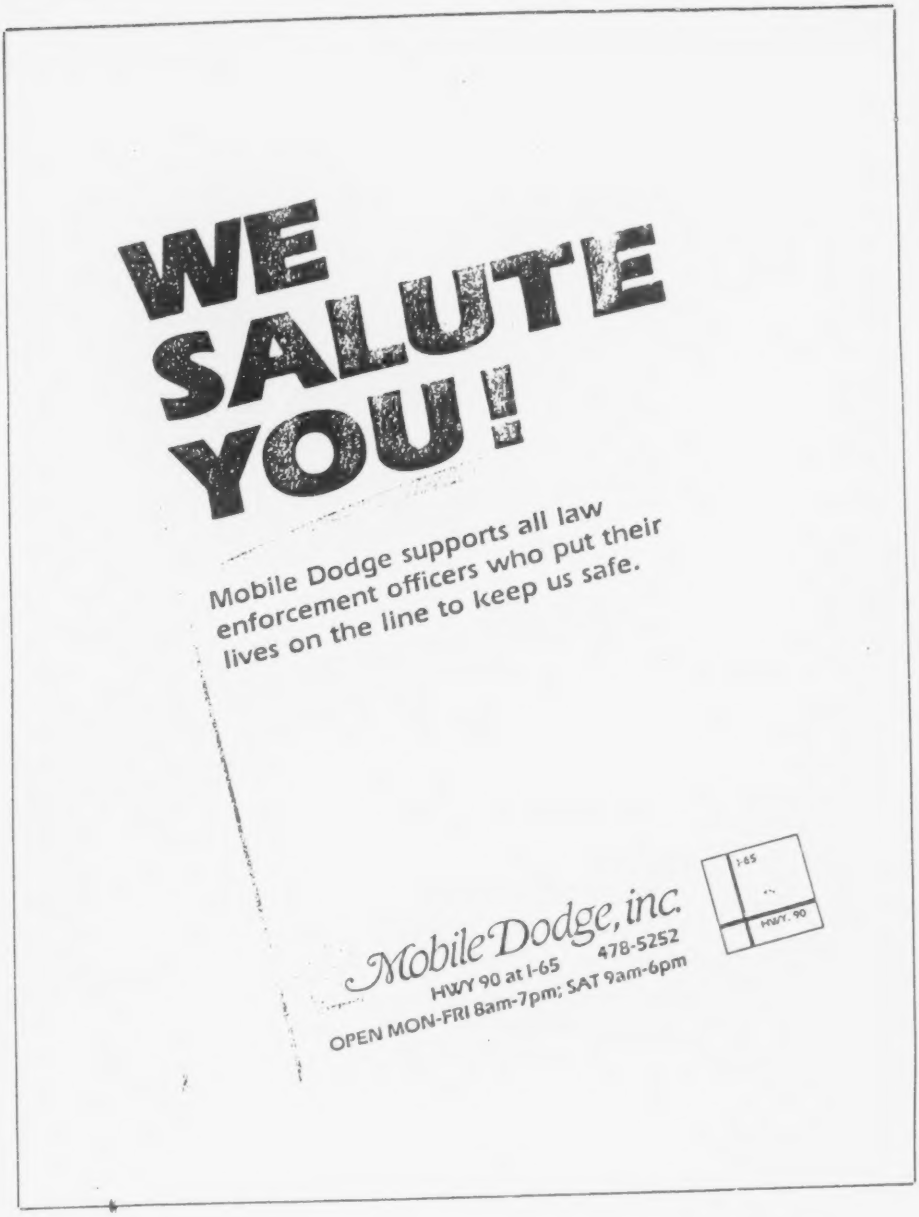
Tate, Heinz and Ellis
403 Broad Street
Selma

Quality Air Condition and Heating
101 Old Montgomery Road
Selma

Winter, 1987/55

EXHIBIT B
to
Statement of Fraternal Order of Police
State Lodge of Alabama
Before the Subcommittee on Oversight

June 29, 1987



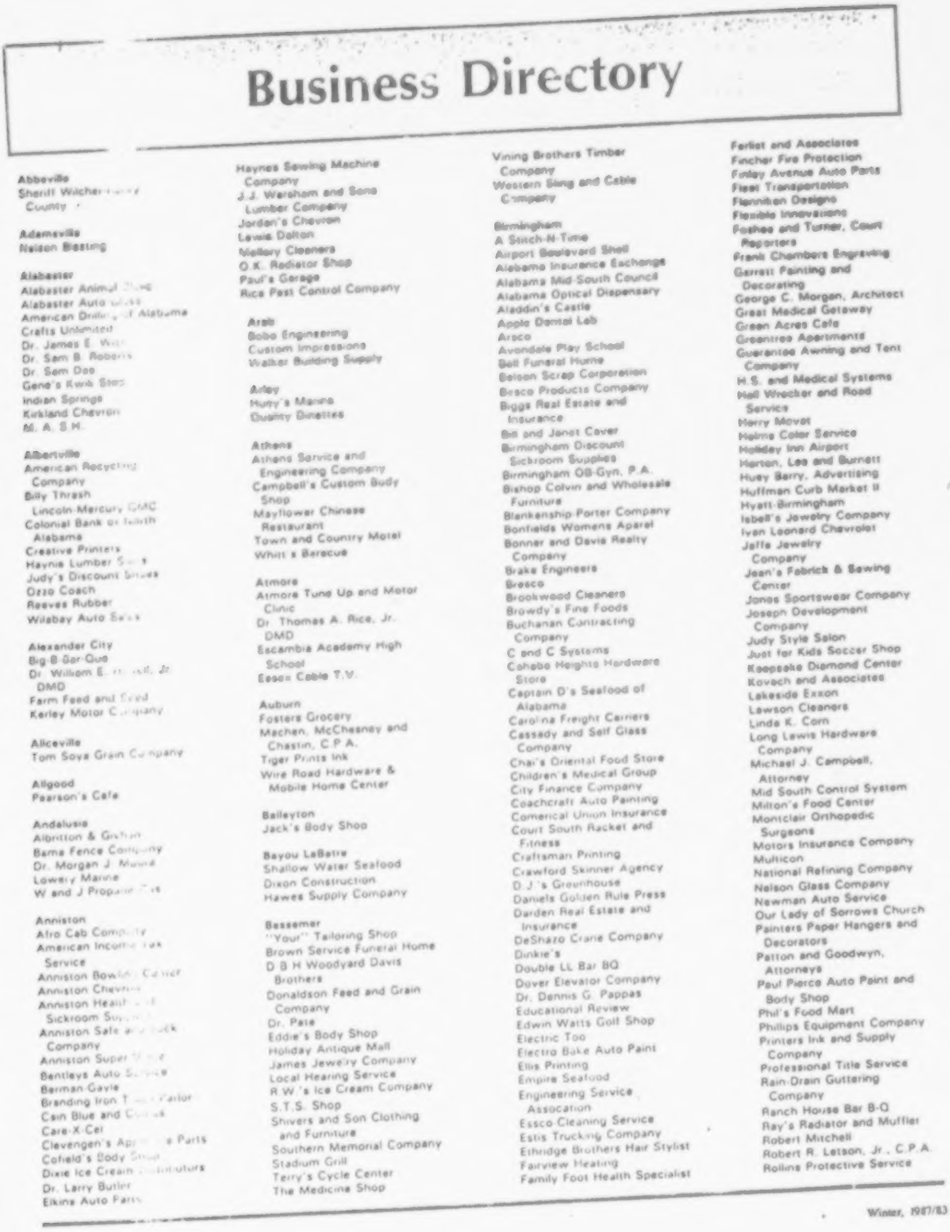
WE SALUTE YOU!

Mobile Dodge supports all law enforcement officers who put their lives on the line to keep us safe.

Mobile Dodge, inc.
HWY 90 at I-65 478-5252
OPEN MON-FRI 8am-7pm; SAT 9am-6pm

EXHIBIT C
to
Statement of Fraternal Order of Police
State Lodge of Alabama
Before the Subcommittee on Oversight

June 29, 1987



Business Directory

Abbeville
Sherill Witcher [illegible]
County

Adamsville
Nelson Blasting

Alabaster
Alabaster Animal Clinic
Alabaster Auto Glass
American Drilling of Alabama
Crafts Unlimited
Dr. James E. [illegible]
Dr. Sam B. Roberts
Dr. Sam Doe
Gene's Kwik Stop
Indian Springs
Kirkland Chevron
M. A. S.H.

Albertville
American Recycling
Company
Billy Thrash
Lincoln-Mercury GMC
Colonial Bank of North
Alabama
Creative Printers
Haynie Lumber Sales
Judy's Discount Shoes
Ozzo Coach
Reeves Rubber
Wilabay Auto Sales

Alexander City
Big-B-Bar-Que
Dr. William E. [illegible], Jr.
DMD
Farm Feed and Seed
Kerley Motor Company

Aliceville
Tom Soya Grain Company

Allgood
Pearson's Cafe

Andalusia
Albritton & [illegible]
Bama Fence Company
Dr. Morgan J. Moore
Lowery Marine
W and J Propane Gas

Anniston
Afro Cab Company
American Income Tax
Service
Anniston Bowling Center
Anniston Chevron
Anniston Health and
Sickroom Supplies
Anniston Safe and Lock
Company
Anniston Super [illegible]
Bentleys Auto Service
Berman-Gayle
Branding Iron [illegible] Parlor
Cain Blue and [illegible]
Care-X-Cel
Clevengen's Appliance Parts
Cofield's Body Shop
Dixie Ice Cream Distributors
Dr. Larry Butler
Elkins Auto Parts
Haynes Sewing Machine
Company
J.J. Wareham and Sons
Lumber Company
Jordan's Chevron
Lewis Dalton
Mallory Cleaners
O.K. Radiator Shop
Paul's Garage
Rice Pest Control Company

Arab
Bobo Engineering
Custom Impressions
Walker Building Supply

Ariey
Hutty's Marine
Quality Dinettes

Athens
Athens Service and
Engineering Company
Campbell's Custom Body
Shop
Mayflower Chinese
Restaurant
Town and Country Motel
Whitt's Barbecue

Atmore
Atmore Tune Up and Motor
Clinic
Dr. Thomas A. Rice, Jr.
DMD
Escambia Academy High
School
Eason Cable T.V.

Auburn
Fosters Grocery
Machen, McChesney and
Chastin, C.P.A.
Tiger Prints Ink
Wire Road Hardware &
Mobile Home Center

Baileyton
Jack's Body Shop

Bayou LaBatre
Shallow Water Seafood
Dixon Construction
Hawes Supply Company

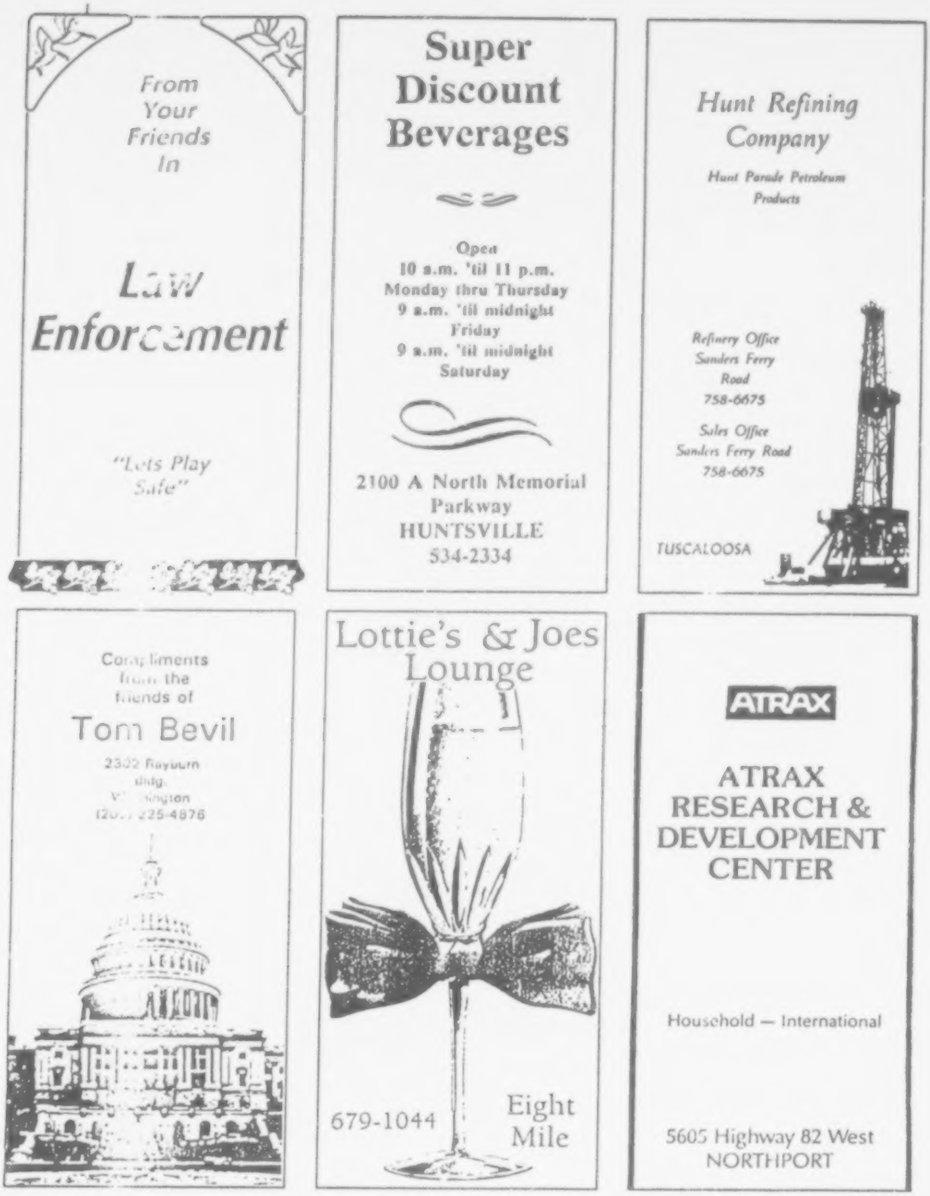
Bessemer
"Your" Tailoring Shop
Brown Service Funeral Home
D B H Woodyard Davis
Brothers
Donaldson Feed and Grain
Company
Dr. Pate
Eddie's Body Shop
Holiday Antique Mall
James Jewelry Company
Local Hearing Service
R.W.'s Ice Cream Company
S.T.S. Shop
Shivers and Son Clothing
and Furniture
Southern Memorial Company
Stadium Grill
Terry's Cycle Center
The Medicine Shop
Vining Brothers Timber
Company
Western Sling and Cable
Company

Birmingham
A Stitch-N-Time
Airport Boulevard Shell
Alabama Insurance Exchange
Alabama Mid-South Council
Alabama Optical Dispensary
Aladdin's Castle
Apple Dental Lab
Arsco
Avondale Play School
Bell Funeral Home
Belson Scrap Corporation
Besco Products Company
Biggs Real Estate and
Insurance
Bill and Janet Caver
Birmingham Discount
Sickroom Supplies
Birmingham OB-Gyn, P.A.
Bishop Colvin and Wholesale
Furniture
Blankenship-Porter Company
Bonfields Womens Aparel
Bonner and Davis Realty
Company
Brake Engineers
Bresco
Brookwood Cleaners
Browdy's Fine Foods
Buchanan Contracting
Company
C and C Systems
Cahaba Heights Hardware
Store
Captain D's Seafood of
Alabama
Carolina Freight Carriers
Cassady and Self Glass
Company
Chai's Oriental Food Store
Children's Medical Group
City Finance Company
Coachcraft Auto Painting
Comerical Union Insurance
Court South Racket and
Fitness
Craftsman Printing
Crawford Skinner Agency
D.J.'s Greenhouse
Daniels Golden Rule Press
Darden Real Estate and
Insurance
DeShazo Crane Company
Dinkie's
Double LL Bar BQ
Dover Elevator Company
Dr. Dennis G. Pappas
Educational Review
Edwin Watts Golf Shop
Electric Too
Electro Bake Auto Paint
Ellis Printing
Empire Seafood
Engineering Service
Assocation
Essco Cleaning Service
Estis Trucking Company
Ethridge Brothers Hair Stylist
Fairview Heating
Family Foot Health Specialist
Ferlist and Associates
Fincher Fire Protection
Finley Avenue Auto Parts
Fleet Transportation
Flennikan Designs
Flexible Innovations
Foshee and Turner, Court
Reporters
Frank Chambers Engraving
Garrett Painting and
Decorating
George C. Morgan, Architect
Great Medical Getaway
Green Acres Cafe
Greentree Apartments
Guarantee Awning and Tent
Company
H.S. and Medical Systems
Hall Wrecker and Road
Service
Harry Movat
Helms Color Service
Holiday Inn Airport
Horton, Lee and Burnett
Huey Berry, Advertising
Huffman Curb Market II
Hyatt-Birmingham
Isbell's Jewelry Company
Ivan Leonard Chevrolet
Jaffe Jewelry
Company
Jean's Fabrick & Sewing
Center
Jones Sportswear Company
Joseph Development
Company
Judy Style Salon
Just for Kids Soccer Shop
Keepsake Diamond Center
Kovach and Associates
Lakeside Exxon
Lawson Cleaners
Linda K. Corn
Long Lewis Hardware
Company
Michael J. Campbell,
Attorney
Mid South Control System
Milton's Food Center
Montclair Orthopedic
Surgeons
Motors Insurance Company
Multicon
National Refining Company
Nelson Glass Company
Newman Auto Service
Our Lady of Sorrows Church
Painters Paper Hangers and
Decorators
Patton and Goodwyn,
Attorneys
Paul Pierce Auto Paint and
Body Shop
Phil's Food Mart
Phillips Equipment Company
Printers Ink and Supply
Company
Professional Title Service
Rain-Drain Guttering
Company
Ranch House Bar B-Q
Ray's Radiator and Muffler
Robert Mitchell
Robert R. Letson, Jr., C.P.A.
Rollins Protective Service

Winter, 1987/83

EXHIBIT D
to
Statement of Fraternal Order of Police
State Lodge of Alabama
Before the Subcommittee on Oversight

June 29, 1987



From
Your
Friends
In

Law
Enforcement

"Lets Play
Safe"

**Super
Discount
Beverages**

Open
10 a.m. 'til 11 p.m.
Monday thru Thursday
9 a.m. 'til midnight
Friday
9 a.m. 'til midnight
Saturday

2100 A North Memorial
Parkway
HUNTSVILLE
534-2334

*Hunt Refining
Company*

*Hunt Parade Petroleum
Products*

*Refinery Office
Sanders Ferry
Road
758-6675*

*Sales Office
Sanders Ferry Road
758-6675*

TUSCALOOSA

Compliments
from the
friends of
Tom Bevil

2302 Rayburn
Bldg.
Washington
(202) 225-4876

Lottie's & Joes
Lounge

679-1044

Eight
Mile

ATRAX

**ATRAX
RESEARCH &
DEVELOPMENT
CENTER**

Household — International

5605 Highway 82 West
NORTHPORT

Winter, 1987/25

EXHIBIT E
to
Statement of Fraternal Order of Police
State Lodge of Alabama
Before the Subcommittee on Oversight

June 29, 1987

Chairman PICKLE. Thank you, sir.

Now, Mr. Crowson, if you will proceed about the great University of Texas.

STATEMENT OF JAMES L. CROWSON, VICE CHANCELLOR AND GENERAL COUNSEL, THE UNIVERSITY OF TEXAS SYSTEM

Mr. CROWSON. Thank you, sir. I will do two things, Mr. Chairman. I will first very briefly summarize the written testimony that I submitted and then I will comment on the recommendations or suggestions that were made in the testimony from the Treasury Department.

We hope that the committee, when it has received all testimony on the subject, will have as much accurate information as it needs to make a decision. We pledge to help in that regard as much as we can.

The focus of my testimony will be on universities and academic medical centers but many of the observations are equally applicable to the other types of exempt organizations.

Contrary to the repeated assertions you have heard, the statutory and regulatory provisions governing the unrelated business income tax law are not so complex and confusing that the existing law cannot be administered.

Most of the areas complained of—from laboratory testing to university book stores to alumni tours—have been effectively addressed by the Internal Revenue Service. A low level of information and enforcement activity by the Internal Revenue Service, however, together with seeming inability of the IRS to retain experienced and capable exempt organization specialists, has resulted in a great lack of understanding and awareness of the IRS decisions which have been made.

The standard utilized in existing law is not so vague and uncertain as to render the current law ineffective. Numerous possible alternative articulations have been tried over the period since 1950 and found wanting.

The existing standard enables a particular activity to be judged against the exempt purpose of the dozens of different types of exempt organizations. For all, however, the activity must contribute importantly to the accomplishment of the exempt purpose of the organization.

It would create a difficult and burdensome new responsibility for both the exempt organization and the Internal Revenue Service if competitiveness were to be adopted as a criterion for application of the unrelated business income tax.

These hearings should also demonstrate the difficulty of legislating against unfair competition when people have so many different ideas as to what is fair. Congress should adhere to the basic objective of taxing an unrelated activity on the same basis as a for-profit independent business activity, and the Congress should also continue to recognize traditional exceptions for those specific situations where public policy justifies the conduct of those types of activities.

The Treasury Department in its testimony suggested, as I have already alluded to, that the substantially related test be retained.

We would agree with that. We think that it is administrable and with proper enforcement and compliance can work.

Treasury suggests more detailed reporting. We would agree from the figures that we have seen that the Internal Revenue Service needs to gather more information with regard to the size of the animal, if you will, that it is dealing with, and we will try to be helpful in that regard.

Treasury had suggested that it needs to develop information on the use of volunteer services in not-for-profits where the income that results from the use of volunteers is not taxable. We would agree that the information may be needed in that area but we don't see any resultant effect on universities one way or the other.

The Treasury Department has suggested that there is a need to develop information on the convenience exception primarily applicable to provision of services to students on university campuses. We want to comply with the wishes of the Internal Revenue Service and will try to help provide information. We believe that, by and large, however, the current regulations work correctly. Current law would keep a university from selling in its bookstore, without paying unrelated business income tax, cameras, expensive suits and items of that nature.

Treasury has suggested overturning the *Rensselaer* decision which has to do with the allocation of expenses for a taxable activity that takes place in facilities otherwise used for nontaxable events. Treasury would like to allocate on the basis of a theoretical availability of those facilities rather than actual use. We think that that's not appropriate and would not be the test that would be applied in a for-profit to for-profit situation.

The Treasury Department is suggesting reducing the controlled subsidiary ownership percentage test from 80 percent to 50 percent. We are not aware at the University of Texas of any abuses in that regard, and would not object to such a change but would suggest, however, that the test not be made retroactive just in terms of some arrangements that may have been made by others.

It is suggested that the activities of exempt organizations be aggregated in appropriate cases and then tests be applied to see whether the activity has become more for-profit than not-for-profit, and that is certainly not an objectionable idea.

The Treasury Department has suggested retaining the exemption passive income. We certainly believe that should be done.

The Treasury Department has suggested removing the exemption for net profit royalties in certain kinds of arrangements—leaving aside mineral royalties. We would suggest that that needs to be looked at very carefully in terms of the technology transfer programs that universities are entering into.

It is very difficult to transfer technology from the laboratory to the marketplace. There needs to be a bridge. The bridge is, indeed, the private enterprises, and it is difficult in many areas to make an arrangement with private enterprises that does not involve a gross formula.

It has been suggested that the exemption for royalties be done away with if it has to do with exploiting good will, and having heard some of the testimony today, I understand that a little bit differently, but let me talk about it a little bit in a university context. I can do that by giving a little anecdote.

Several years ago a professional basketball team—which I will not name but which you will probably recognize—moved into the Dallas area. It adopted the name of the sports efforts of a local university that is associated with the University of Texas.

The question became "How could we protect the name we had been using?" Now, we could have gone to court under common law provisions relating to trademarks and goodwill and probably have won after expensive litigation.

We chose not to do that, however, and renamed the sports teams at UT Arlington a different name. However, if at the time we did that, we had had our trademarks registered both at the state and federal level, we suspect that the basketball team would not have used that name.

Now, once you have established and expressed your ownership and registered which we have now done, Mr. Pickle, for the Longhorns and everybody else, once you have done that, you have to continue to protect it.

So that we can protect we do license, therefore, the name of the University of Texas and the logos to be used on certain kinds of things—sweat shirts and T-shirts—and the like. There is income associated with that, but it is almost incidental to the reason that we have gone into the licensing endeavor which is to protect the goodwill associated with the University of Texas, wherever it is. There may be other arrangements, but in our particular case, those proceeds are restricted for scholarship uses. The proceeds from the licensing activities associated with the logos and trademarks are restricted to scholarships.

It has been suggested that there needs to be additional guidance concerning nonexempt applied commercial activities such as testing. We suggest that that is also true. The public seems largely unaware that, by and large, testing results in unrelated income.

The Treasury Department has suggested tightening the allocation rules for partnerships and joint ventures to prevent some kinds of abuse. If there are abuses there, they certainly need to be addressed. We would only suggest that those allocation procedures need to reflect the true economics of the situation just as they would in a situation where taxable entities are dealing with each other.

Thank you very much.

[The prepared statement follows:]

Statement by

JAMES CROWSON

HEARINGS BEFORE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

June 29, 1987

Mr. Chairman and Members of the Subcommittee:

I am James L. Crowson, Vice Chancellor and General Counsel of The University of Texas System. I would like to respond to some of the more common assertions I have heard concerning the revenue- generating activities of universities and university-related hospitals. I believe that some of the public debate has been based on misunderstandings as to what the current law provides. As a result, some misleading statements have been made. I do not want to assert that the current law is perfect---nothing in our tax code satisfies everyone---but I do want the members of this Subcommittee to have accurate information about the operation of the existing law and regulations.

Assertion: The statutory and regulatory provisions governing the unrelated business income tax are so complex and confusing that the existing law cannot effectively be administered.

Response: The prevailing judgment of those attorneys, accountants and administrators who work extensively with the unrelated business income tax provisions is that the Internal Revenue Service can effectively administer the existing law. Although these provisions are as complex as many other areas in the federal tax code, the great majority of these experienced practitioners find the current law to be logical and reasonably comprehensible. However, the current law is not well-known by many administrators and even professional tax advisors can be confused if they do not regularly practice in the area. Moreover, the administration of these provisions by the Internal Revenue Service is a challenge, for the IRS has not been able to retain experienced Exempt Organizations Specialists at the field level and has not been able to provide a level of public guidance comparable to other areas of IRS administration.

Experience shows that time after time, capable IRS agents intentionally leave the Exempt Organizations side of the IRS to get into the "tax-raising" individual and corporate income tax areas of IRS responsibility. This is unfortunate from our perspective, because it is more difficult for the IRS to utilize inexperienced employees in the administration and enforcement of the exempt organizations provisions than in individual and corporate income tax matters. The concepts of the unrelated business income tax are generally not taught in basic law school tax courses or undergraduate accounting programs, and the wide variety of exempt organizations requires an individual working with them to develop a level of judgment which only comes from training and exposure. With well-trained and experienced personnel, however, there is considerable evidence of the ability of the IRS to make the judgments and distinctions required by the current law.

Moreover, considerable additional resources have to be devoted by the IRS to enforcement and administration if the Congress desires a high level of voluntary compliance with the unrelated business income tax laws. Very little attention is given to communicating the existing law to the exempt organizations which have to abide by it. Sophisticated analyses of complex issues are contained in IRS private rulings and internal memoranda, but very little of this information is known to the administrative staff or volunteer officers of most exempt organizations. Our experience indicates that there is much less "public information" published in this area by the IRS than in other complex areas of tax administration. We believe that there would be a significant improvement in both voluntary compliance and public understanding if more resources were applied by the IRS to the publication of revenue rulings and other materials instructive of the IRS position on these issues.

Assertion: The "relatedness" standard utilized in the current unrelated business income tax law is so vague and uncertain of meaning that virtually any type of revenue-generating activity can be deemed related, and therefore nontaxable.

Response: My university colleagues and I believe that, in the great majority of day-to-day situations, representatives of the Internal Revenue Service and exempt organizations would agree upon whether a particular revenue-generating activity is related or unrelated to the exempt purpose of the organization conducting the activity. Of course, reasonable people may occassionally differ on a specific situation, but we believe the current standard is workable.

It must be understood that there are over two dozen statutorily-defined types of exempt organizations, and there are many more kinds of exempt organizations which fit within these statutory definitions. For example, one statutory category of exempt organizations, section 501(c)(3) charities, encompasses churches, hospitals, universities, research institutes, social welfare agencies and dozens of other types of public benefit organizations.

Consequently, one type of activity may be related to the exempt purposes of a particular exempt organization, yet be unrelated to the exempt purposes of another type of exempt organization. While there is no "formula" or universal definition of "related" as it applies to a particular revenue-generating activity, that is because of the wide diversity of exempt purposes undertaken by exempt organizations, not because of the lack of meaning of the word "related."

For example, the construction and sale of low-cost housing may be directly related to the exempt purposes of a charitable, section 501(c)(3) organization focusing upon urban renewal and improvement in the circumstances of disadvantaged minority citizens, but would be a wholly unrelated activity for a social club described in section 501(c)(7) of the Code.

Similarly, it may be an obviously related activity for a section 501(c)(3) environmental preservation organization to purchase large tracts of land for resale to a state or other custodian of public lands, but the same activity would generally be unrelated for other section 501(c)(3) organizations like hospitals. Thus, the same type of activity could be taxable for one type of charitable organization but non-taxable for another. It is this fact which is often confusing to the uninitiated, but that does not mean that the standard does not work.

Although the current law requires the IRS and the organization to compare the exempt purposes of the organization with the nature of the revenue-generating activity in question, it is clear that the current law has solved the principal problems to which it was addressed. No one doubts that a wholly independent and profitable manufacturing activity owned and operated by a university produces taxable income for the university. No one wonders whether a hospital is supposed to pay income tax on profits it generates from a consumer electronics store it owns and operates. The vast majority of the revenue-generating activities of exempt organizations have already been identified and categorized by the IRS as taxable or not. Certainly, there are disagreements between taxpayers and the IRS in this area, just as in every other area of the tax law, but it is the exception, rather than the rule, that the IRS faces such a novel situation that it is uncertain how to apply existing law.

Assertion: An activity's revenues should be taxable if the activity is "competitive" with a for-profit business.

Response: Some persons apparently believe that a university should pay tax on any activities which are "in competition with" a for-profit business. This approach was considered by the Congress in 1950 when the existing unrelated business income tax structure was added to the Internal Revenue code, and the desire to prohibit unfair competition by imposing income tax on unrelated activities was an underlying purpose for the statutory provisions. However, "competition" was not added as a condition to, or occasion for, taxability in the statute, because the Congress understood that "market" conditions frequently change over time. Numerous activities conducted by exempt organizations have had no for-profit competition in the past, but now do have competition from for-profit businesses. Similarly, exempt organizations may not have competition in the future from for-profit businesses which are competing currently. Thus, to base taxability upon the presence or absence of competition with a for-profit business would create a difficult and variable pattern of measurement, would render enforcement more difficult by requiring "market surveys" rather than an examination of a specific organization's own activities, and would disrupt normal planning efforts by requiring "crystal ball" forecasts of the presence or absence of a for-profit competitor.

Moreover, the Congress in 1950 intended to eliminate unfair competition, not all competition, with for-profit businesses. At the same time, the Congress realized that "fair competition" was not the only public policy which was relevant. For example, the Congress in 1950 did not want to disrupt traditional revenue-generating activities, such as sales of milk by agricultural colleges. The Congress also recognized that university research was so vital to our national well-being that it should be especially protected. We believe that these same broad public policies exist today and that no single consideration such as "competitiveness" should outweigh all others.

Assertion: The confusing statutory and regulatory treatment of "research" has enabled exempt organizations to engage in unfair competition with commercial laboratories by conducting extensive laboratory testing services.

Response: The statutory and regulatory treatment of research is straightforward.

> First, revenues derived from research are not taxable if the research is substantially related to the exempt purposes of the organization conducting the research.

Second, three specific categories of research have been statutorily declared to be exempt from the unrelated business income tax: (1) research for a governmental agency, (2) research by a college or university, and (3) research by a basic ("fundamental") research institute if the results are made publicly available.

Third, the regulations carefully differentiate between "testing" and "research" for the purpose of these three specific exemptions, so that "testing" is not protected from tax. This regulatory provision has been upheld judicially.

Fourth, related testing activities are protected from tax only where the testing serves a specific exempt purpose, e.g., collecting an adequate number of specimens to conduct a scientifically valid research project, and the testing service is not operated on a scale larger than is necessary to accomplish that exempt purpose.

Most of the publicized criticism of testing activities appears to ignore two facts. First, unrelated testing activities do produce income subject to tax. Because the three specific research exemptions do not apply to testing, universities as well as hospitals and other exempt organizations are taxable on net revenues from unrelated testing activities. Second, related testing activities do not produce taxable income because the testing is serving a public purpose such as compiling data needed in searching out cure and treatment for disease, training students how to perform tests, or enabling the efficient and effective treatment of a patient while the patient is phsycially present in the hospital. Granted, some of this related testing may be competitive with large and small businesses in narrow areas of activity, but the past wisdom of the Congress, supported by most businessmen and public servants, has been that, on balance, the contributions to society made possible by medical and scientific research, the education of students, and the care of the sick at the lowest possible cost justify relief from income taxation. Our hope is that the Congress will continue to weigh these considerations in the same way.

Assertion: University bookstores pay no tax on sales of ordinary commercial products and thereby compete unfairly with for-profit bookstores, department stores and other merchandisers.

Response: It is only partially true that bookstore sales are exempt from tax. Many types of merchandise can be sold on a regular and consistent basis to students and faculty members (but not the general public) by a university bookstore without incurring income tax. This protection from tax arises directly under the "convenience exception," as well as more generally under the "substantially related" standard for evaluating a university's revenue-generating activities. Universities have a legitimate, long-term interest in ensuring that their students and faculty members have a ready and reliable source of textbooks, supplies and materials commonly used in the educational process. Moreover, many college students reside on campus in locations remote from an available business establishment, and it is reasonable for schools to maximize "study time" by minimizing "shopping time."

However, this does not mean that a university can operate a full service "department store" on campus and avoid tax under the convenience exception of existing law. The Internal Revenue Service has imposed a "durable goods" limitation upon the utility of the convenience exception, which considers the type of goods sold and the degree of geographical remoteness of the campus from other vendors of the goods in question. Food, books, magazines, notepapers and other "consumable" products generally fit within the convenience exception, but television sets, refrigerators and other "durable goods" generally do not. See, e.g., IRS General Counsel's Memorandum 35811 (May 7, 1974) identifying radios, televisions, refrigerators, cameras, jewelry and clothing other than sundry items as generally not within the convenience exeption.

We realize that there may still be a few "gray areas" regarding bookstores, and we certainly do not condone any abuses which may have occurred. However, on balance, we feel that the current statute and regulations provide effective guidance.

Assertion: Exempt organizations enter into partnerships or joint ventures to expand the economic status of the exempt organization and are able to "trade on their tax exemption to grow larger."

Response: The Congress has repeatedly considered the subject of partnerships involving exempt organizations, and it has already acted to limit any abuses of such partnerships where leased property is involved. The IRS likewise carefully reviews partnership situations to preclude improper private benefit. For example, the tax-exempt entity leasing rules operate to reduce the allowable cost recovery for any building owned by a partnership which has an exempt organization as a partner. Similarly, the IRS has developed a sophisticated analytical technique to ensure that the actual and potential benefits that a private person derives from such a partnership are not unreasonable or excessive. In addition, the law clearly provides that unrelated income earned by a partnership is still unrelated income, and therefore taxable, when distributed to an exempt organization. Given these constraints of existing law, the use of partnerships and joint ventures by universities should be encouraged, not hindered.

There are few, if any, occasions on which an exempt organization would enter into a joint venture merely to increase the magnitude of its operations. My university is a large one, but it is not large because its leaders want more tuition revenues or research grants. It has grown to its current size to serve the people of Texas and beyond, through preparing students for their careers, carrying on research for the benefit of our citizens, our state, our Nation and our business community, and providing direct benefits to our community. Increased size of operations alone would be a highly unusual objective for an exempt organization. On the other hand, the ability to acquire the use of a highly sophisticated and expensive piece of research equipment for use by a university's faculty and students in their research and educational activities is a legitimate reason for the formation of a partnership or joint venture. It is entirely reasonable and justifiable for a university to conclude that 10%, 20% or some other limited portion of the use of a sophisticated research facility is better than none, and if so, a partnership or joint venture arrangement providing the university with that proportional use of the equipment or facility is a rational undertaking.

In like fashion, it is entirely reasonable for a university to enter into a partnership or joint venture to acquire an investment asset, where the asset promises a potential return on the investment which is greater than alternatives available to the university but where the cost of the investment is much greater than the university could afford on its own. For example, a university may not be able to justify investing a substantial portion of its assets in a single oil-producing property, despite the belief that such an investment would be more advantageous than alternatives such as stocks, bonds or other investments. In such a situation, it would be eminently reasonable for the university to obtain a 1%, 5% or other interest in a partnership, perhaps formed with other universities or exempt organizations or with a combination of universities and taxable individuals, to acquire an investment with a potentially high return as a diversification of its investment activities beyond the normal securities portfolio. Obviously, both existing law and university self-interest compel any investment gain from such a project to be used for university purposes, not private benefit.

Finally, a partnership or joint venture is a rational and effective means of accomplishing numerous other objectives which serve the best interests of the university. For example, academic medical centers depend upon a large staff of highly qualified physician-educators to train new physicians, conduct medical research, and care for patients. Such physicians require office space for the examination, diagnosis and treatment of ambulatory patients, for clinical research activities, and for routine medical practice. Such an office facility can be provided by the university alone, by the physicians alone, by a third party, or by a joint venture between the university and the physicians. For a variety of reasons, most of which have nothing to do with the tax laws, the latter approach is often a preferable one.

A joint venture may be desired in such a situation because the certificate of need laws of many states enable an office building primarily financed by physicians to be built without the delay, cost and uncertainty of obtaining a certificate of need, which would usually be required if the university hospital financed the building. Although many states, with Congressional approval, have greatly reduced certificate of need requirements, most states intentionally gave greater latitude to physician-owned facilities than to hospital projects. Similarly, many hospital administrators have learned that they can generate a higher level of physician participation in the design of an efficient building if the physician users bear a portion of the cost and serve as part owners. And, in many cases, the capital investment of the physicians reduces the amount of borrowing the hospital would otherwise do, thereby reducing interest costs. For these and other reasons, a joint venture or partnership serves the hospital's objectives and is not a device to abuse our tax laws.

Assertion: Universities and their alumni associations are unfairly competing with travel agencies and tour promoters, in that they pay no tax upon their travel agency revenues.

Response: This assertion is wrong in those situations where the tours have no formal educational program conducted in connection with them. In 1978, the Internal Revenue Service ruled that the revenues derived by an alumni association from the operation of a travel tour program for alumni and their families constitute unrelated business income. The situation addressed by that rule, Rev. Rul. 78-43, 1978-1 C.B. 164, involved an arrangement with various travel agencies in planning package tours, mailing promotional tour brochures and receiving reservations. The association was paid a per person fee by the travel agency. Although the alumni association provided an employee to accompany each tour to serve as a tour leader. This type of activity was ruled unrelated and the income was therefore taxable to the alumni association. Thus, any competitive advantage resulting from the alumni association's income tax exemption disappeared.

Similarly, the IRS has been able to segregate related from unrelated travel and tour services operated by a single organization, so that the unrelated travel and tour service revenues are subject to tax. For example, in Private Letter Ruling 8217008 (Jan. 26, 1982), the IRS classified as related, and therefore non-taxable, travel services in arranging overseas academic study by individual students and arranging a faculty supervised summer political science program in a foreign country for a group of students, but classified as unrelated, and therefore taxable, services in arranging unstructured recreational travel for students or faculty, as well as travel services provided to the general public.

The travel agency issue is also a good case study of how factors having nothing to do with "profit" or the tax laws have led to a situation of alleged unfair competition. Most university travel services were initiated in the days prior to deregulation of the airline industry, when it was essential, in order to obtain the cost savings available to large purchasers, that the travel agency be available to the "general public." Many universities encountered substantial airline travel costs for their faculty members, staff and athletic teams, and they desired to establish travel agencies in order to obtain the reduced prices, through travel agents' commissions, which were available from the airlines. Most large universities had staff personnel who were regularly performing travel agent services by making and revising reservations, issuing tickets or flight checks, and similar services, so they sought the available cost reductions. They originally had no interest in selling tickets to students generally, much less selling to the general public. But the industry rules would not allow a university (or a business corporation, for that matter) to operate an "in-house" travel agency which restricted the availability of its travel agent services to its employees.

For example, the 1979 Manual of Traffic Conference Resolutions (Passenger) of the International Air Transport Association provided that airlines which were members of the Association could pay "sales agency remuneration" only to "Approved Agents," and that to be an "Approved Agent," the travel agent's "place of business" must be "identified as a travel agency, [be] open for business on a regular schedule in accordance with local business practices, and freely accessible to the general public for the sale of international air transportation, and [do] at least 80% of its business with members of the general public." Resolution 810 (USA), Section C, paragraph (5). Effective July 1, 1984, this rule was revised to permit an "In-Plant Location," and the "80% general business" condition was deleted. However, "In-Plant Locations" could be approved only if the application was "for a branch of an Approved Agent." Thus, although the 1984 changes removed the specific 80% test for actual ticket sales required to be made to the general public, the industry's rules still required that the travel agency be "freely accessible to the general public." IATA Passenger Agency Conference Resolutions Manual (5th Edition), Resolution 802, Section C, paragraph (5). All of this meant that, in order for universities to reduce their airline travel costs, they were forced by the rules of the industry--rules created by the businesses participating in that industry--to make their travel agency services available to the general public. To reduce their costs of operation, universities were effectively compelled to become competitors in ticket sales to the public. However, as described above, those ticket sales not educationally related do produce income subject to tax.

Assertion: Universities, hospitals and other exempt organizations have created taxable subsidiaries to avoid the consequences of the unrelated business income tax provisions.

Response: It is difficult to see how income tax can be avoided by conducting revenue-generating activities in a taxable subsidiary. The income of the subsidiary would be taxable. The subsidiary cannot avoid tax by paying profits to the parent in the form of rent, royalties, interest or annuities, for such payments become taxable to the parent if the revenue-generating activities of the subsidiary are unrelated to the parent's exempt purposes. Code section 512(b)(13). Dividends paid to the parent would not become taxable to the parent, but they are not deductible by the subsidiary in computing its tax liability. A charitable contribution deduction is not available for the subsidiary's transfers to the parent; rather, such transfers are treated as nondeductible dividend payments. If the subsidiary attempts to avoid tax by paying expenses not properly attributed to its activities but to the parent's, the IRS can readily reallocate income or expense between the two entities just as it routinely does between two taxable entities.

Assertion: Unrelated business activities conducted by taxable subsidiaries of exempt organizations have an unfair advantage because they can draw upon the untaxed endowment funds and earnings of the parent corporation.

Response: There is no unfair advantage because taxable subsidiaries encounter the same cost of capital as their for-profit counterparts. Even if a university were to create a taxable subsidiary to engage in a wholly unrelated business activity, the university would provide funds to the subsidiary, as either an equity investment or a loan, only if it expected a return on that investment. Experience shows that universities currently attempt to maximize the return on all of their investments, whether in traded stocks or in less-liquid assets. They expect either dividends or interest, in most cases, or some other form of return, such as a gain upon sale of the business, and the obligation to pay those dividends, interest or other amounts is just as burdensome for the taxable subsidiary as for the independent business. Thus, both the subsidiary of an exempt organization and the independent business compete on an equal footing, for each pays the appropriate income tax on its net income and each pays its investor a market rate of return on the investment.

Assertion: Universities and other exempt organizations should be taxable on their passive investment income because they are able to utilize that income to engage in competitive business activities.

Response: If passive investment income is subject to tax, the basic exemption from income tax becomes largely irrelevant for most exempt organizations. Few universities, for example, would generate any net profit from their tuitions and fees. The Congress decided long ago that churches, hospitals, universities and other exempt organizations were providing a benefit to society which outweighed the desire for taxing their revenues. The purpose and effect of the current unrelated business income tax law are to put business entities and exempt organizations on an equal basis in terms of the "tax cost" of engaging in a business activity unrelated to exempt purposes. Investment activities, such as the ownership of stocks, bonds, rental real property, and royalty-producing interests, have gener- ally been viewed as "passive" in nature and therefore not creating competition with "active business" pursuits of for-profit enterprises. So long as the income of an un- related business is subject to tax, and so long as exempt organizations demand a market return on their investment, the unrelated business is not unfairly competing with an inde- pendent business.

Assertion: Universities and hospitals which advertise their basic services have become more commercial and have consequently lost their sense of mission and purpose.

Response: Factors having nothing to do with "profit creation" have prompted universities and university hospitals, as well as hospitals generally, to engage in the advertising of their basic educational or health care services. Demographically, the number of potential college students has declined in recent years, and the number of colleges and universities has increased. As a result, the student enrollments at many colleges declined, prompting the leadership of those schools naturally to explore ways of attracting an adequate number of students to maintain the quality of their programs. A "critical mass" of students and faculty is essential if college-level education is to occur, and the number of students and faculty is larger at a multidisciplinary university like mine than at a liberal arts college. Yet, both types of schools wish to attract an adequate number of the highest possible quality students. As the available "pool" of potential students has decreased in size, it is not a profit motive but a service motive which has encourage schools to "advertise" in order to communicate with more potential students.

A similar set of factors has affected hospitals, especially general, community hospitals more than university affiliated hospitals. Advances in technology and medical knowledge and financial pressures from governmental and private medical insurance providers have reduced the number of days of hospitalization per patient. As a consequence of this factor and the recent entry of the for-profit hospitals into the field, there has developed a significant national oversupply of hospital beds, which has made it difficult for many hospitals to continue operating if they rely primarily upon charges to patients (or insurance programs covering those patients). Consequently, it has been a normal reaction for a hospital to seek a greater share of the patient population in order to maintain the stability of its own operations, and advertising has been one method adopted by many hospitals to maintain their patient levels. These efforts by universities and hospitals are not evidence of a "commercial" or "profit-oriented" motivation, but of a desire to maintain their traditional services to the public.

Assertion: A hospital laundry has an unfair competitive advantage in providing laundry services not only for itself but also for surrounding hospitals, since the hospital pays no income tax.

Response: It is amazing how misleading public comment can often be. Since the Supreme Court decision in HCSC-Laundry v. U.S. 450 U.S. 1 (1981), it has been clear that a cooperative hospital laundry service is not tax-exempt, and it necessarily follows that the sale of laundry services by one hospital to another hospital or other organization generates unrelated business taxable income. Internal Revenue Code § 513(e). Although the Congress has seen fit to encourage a lowering of health care costs by cooperative hospital purchasing, data processing and other arrangements through the enactment of Code sections 501(e) and 513(e), the Congress intentionally did not extend that encouragement to hospital laundries.

Assertion: Hospitals are allowed to sell hearing aids without paying tax on the sales proceeds and thereby compete unfairly with hearing aid businesses.

Response: It is correct that in specific circumstances, hospitals can sell hearing aids to patients without incurring tax. In 1978, the Service ruled that a hospital, the primary activity of which is the operation of a clinic that provides rehabilitation services to handicapped individuals, including those with hearing deficiencies, could sell hearing aids to its patients as an activity incidental to the testing and evaluation of the hearing deficiencies of those patients and not be subject to tax. Rev. Rul. 78-435, 1978-2 C.B. 181. However, the same conclusion would not be reached if the individual purchasing the hearing aid were not a "patient" of the hospital, and the Internal Revenue Service has adopted a restrictive definition of the term "Patient." See Rev. Rul. 68-376, 1968-2 C.B. 246. Moreover, the same result would not likely be reached if the hospital were not involved in the testing and evaluation of patients with hearing deficiencies. While it is possible that the "convenience exception" might apply to protect sales of hearing aids to hospital patients even where the hospital does not have a hearing deficiency program, such a result is doubtful in light of the "durable goods" exception to the convenience exception developed in the university bookstore context, discussed above.

Assertion: Hospital pharmacies and drugstores unfairly compete by making nontaxable sales of drugs and other supplies to the general public.

Response: In 1968, the Internal Revenue Service ruled that the sale of pharmaceutical supplies to the general public by a hospital pharmacy has no substantial casual relationship to the hospital's exempt purposes. Accordingly, the income derived by the hospital from the sale of pharmaceutical supplies to the general public constitutes unrelated business taxable income. Rev. Rul. 68-374, 1968-2, C.B. 242.

CONCLUSION

The current debate should be an informed one, and I have attempted to demonstrate that many of the widely-publicized assertions of "unfair competition" are legally or factually incorrect, or are at least misleading. There may well be areas where greater certainty or simplification in the law can be provided, but any legislative changes should be firmly grounded upon an accurate understanding of the current law and its operation.

Chairman **Pickle**. Thank you, Mr. Crowson.

Now, we have one other witness, Mr. Ducate. Please proceed.

STATEMENT OF DOUGLAS L. DUCATE, IMMEDIATE PAST PRESIDENT, NATIONAL ASSOCIATION OF EXPOSITION MANAGERS

Mr. **Ducate**. Thank you, sir.

Mr. Chairman, members of the committee, my name is Douglas Ducate, and I am the associate executive director of the Society of Petroleum Engineers, the 57,000-member 501(c)(3) professional society whose world headquarters are located in Richardson, Tex.

I am here today representing the National Association of Exposition Managers, a 2,500 member organization whose members are employed by both tax exempt and taxable organizations and who plan and organize 80 percent of the some 5,000 trade shows produced in the United States each year. I served as the 1986 president of NAEM.

You have received my written testimony regarding the position of our association with regards to UBIT, and this afternoon, I have three specific points that I would like to share for your deliberations.

First, tax exempt organizations do not have a competitive advantage in the trade show field. To illustrate this point, in 1986, 49 of the largest 100 trade shows produced in America were organized by taxable organizations.

As my written testimony indicates, there are some 330 taxable companies actively organizing trade shows in the United States, and that number is growing steadily. These taxable organizations actually have a competitive advantage over the tax exempt groups because they are free to pursue opportunities in any area and every industry and most importantly they can discontinue any unprofitable events.

Associations, on the other hand, are limited usually to the single industry they serve, and are compelled to produce trade shows notwithstanding the relative health of their industry.

In the case of my industry, the petroleum industry, during the 20 years that I have been with the Society of Petroleum Engineers, I have seen the trade show activity accelerate and diminish concomitant with the activity level in the industry. Following the Arab oil embargo some 15 years ago, the number of petroleum related trade shows worldwide doubled, with most of the new events being organized by taxable entities. Today, with the petroleum industry in a depressed state of activity, the number of industry trade shows has fallen to the pre-embargo level. The taxable organizations have abandoned their oil events and focused their attention on more profitable industries such as computers and electronics.

The reason we continue to organize trade shows for the petroleum industry speaks to my second point, which is trade shows are inactively consistent with the tax-exempt mission of the organization. Historically, Congress has consistently agreed with this position and, in reviewing the testimony of the Treasury Department, we find no question from them concerning the exemption of trade show revenues.

Unlike many of the gray areas in the application of UBIT, trade shows are uncomplicated and are substantially related.

Third, Treasury's testimony suggests many tax-exempt activities have not been reviewed in 20 years, or in light of today's business environment. This is not true of trade show revenues. Treasury and Congress have reviewed trade show revenues frequently and most recently, sir, your committee and the Senate Finance Committee specifically exempted trade show revenues from UBIT of 501(c)(3) and 501(c)(4) organizations. Trade revenues of 501(c)(6) trade associations were specifically exempted 10 years before in 1976.

To summarize, the NAEM's position made really three points. Trade shows sponsored by taxable entities do not suffer competitively because of tax-exempt trade shows. In fact, NAEM, which represents both taxable and tax-exempt trade show managers, has ample evidence that the taxable trade shows are flourishing. And as my written testimony explains, tax-exempt organizations actually spawn the taxable entities.

Congress has always concluded the trade show income is related to the tax-exempt entities purposes.

And, third, as I have just related, we have reaffirmed their historically consistent position of granting exemption to trade show revenues as recently as 1986.

Thank you.

[The statement of Mr. Ducate follows:]

STATEMENT OF MR. DOUGLAS L. DUCATE
ON BEHALF OF THE NATIONAL ASSOCIATION OF EXPOSITION MANAGERS
ON THE REVIEW OF THE UNRELATED BUSINESS INCOME TAX
BY THE WAYS AND MEANS COMMITTEE'S SUBCOMMITTEE ON OVERSIGHT
JUNE 22, 1987

Mr. Chairman, my name is Douglas L. Ducate. I am the Associate Executive Director of the Society of Petroleum Engineers, a 57,000 member 501(c)(3) organization whose world headquarters are located in Richardson, Texas.

My statement today is made on behalf of the National Association of Exposition Managers (NAEM) of Aurora, Ohio. NAEM is a 59-year-old national, nonprofit organization comprised of exposition managers. Our members produce an aggregate of 4,000 trade shows, or nearly one-half of all the major expositions in the United States. I am currently the immediate past-president of NAEM.

From that day in September of last year when Chairman Rostenkowski asked you to conduct a comprehensive review of "commercial and other income-producing activities of tax exempt organizations," we at NAEM knew we wanted to participate in these hearings and contribute to this committee's understanding of tax exempt organizations' trade show activities and the critical role they play. It is NAEM's position that a tax exempt organization's trade show income deserves to be treated as exempt income and outside the purview of the unrelated business tax. We believe there is ample historical, legislative, and economic justification for this conclusion.

From the very first exemptions granted to a handful of nonprofit organizations in the Revenue Act of 1913, Congress has steadily expanded the list of eligible organizations. In so doing, Congress has confirmed the unique accomplishments of American charitable, educational, scientific, professional and trade associations. Some 150 years ago that wise traveler to these shores, Alexis de Tocqueville wrote in "Democracy in America:"

> "Americans of all ages, all conditions, and all dispositions constantly form associations. They have not only commercial and manufacturing companies, in which all take part, but associations of a thousand other kinds, religious, moral....the Americans make associations to give entertainment, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the Antipodes; in this manner, they found hospitals, prisons and schools. If it is proposed to inculcate some truth or to foster some feeling by the encouragement of a great example, they form a society wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association."

How prescient de Tocqueville was in noting the American association experience and its role in our society. No wonder Congress would encourage their growth by granting tax exempt status to qualifying organizations.

Twentieth century America has witnessed the emergence of trade shows as a major marketing medium, and their growth is directly related to the vigorous and effective sponsorship of them by tax exempt organizations. Trade shows' successes are easily explained, and have absolutely nothing to do with tax policy.

Associations produce expositions to achieve various objectives, such as:

1) Display latest products of an industry to the public, potential users, and manufacturers;

2) Disseminate information;

3) Encourage scientific thinking that leads to new product development and improved standard of living; and,

4) Foster global trade.

Motivated by these objectives, associations were a natural catalyst to spur the growth of trade shows in this country. In fact, associations, by their very purpose, initiated the early interest and growth in trade shows. It was an ideal way for an association of whatever description to serve its membership and the general public with a universally approved activity. Not surprisingly, associations began to develop professional exposition staff who specialized in trade show management. Indeed, when NAEM was founded 59 years ago, it was, and remained, for nearly four decades a 501(c)(6) organization comprised of members exclusively from tax exempt organizations. It wasn't purposely established to be exclusive; however, the membership reflected the fact that tax exempt association staffs were mainly involved in trade show activity.

Because expositions were conducted on a relatively infrequent basis, some associations made an economic decision to encourage its professional trade show staff to become independent. Thus, taxable entities were spawned by tax exempt groups, and almost without exception, the large, private exposition management firms in America today owe their existence to an earlier connection with a tax exempt organization.

Expositions are commercial activities engaged in by both for-profit and not for-profit sectors. We in the industry like to say, "Show business has become big business," but there are significant differences between the objectives of trade show management who are non-profit and those who are taxable entities. Associations usually serve single-focused industries or professions, while the private exposition entrepreneur is free to pursue business opportunities wherever they may be.

A significant number of trade shows are today owned and organized by for-profit companies, many of whom are publishing companies. This percentage has increased steadily during the last ten years offering incontrovertible evidence that the for-profit sector does not operate at a disadvantage in the exposition marketplace. In fact, as an association executive, I submit that the not-for-profit associations are at the competitive disadvantage because their volunteer committee approach to decision making inhibits their ability to respond quickly to new business opportunities.

In this connection, I quote the remarks of a keynote speaker at a recent NAEM meeting who told the tax exempt association exposition managers that they can expect to confront stiff challenges from the private for-profit sector:

> "The best information suggests there are 333 large show-management firms [taxable entities] running more than 1,500 shows in the United States today. This list is growing. I feel there will be an increase in this field for several reasons. First, think about where we come from. Most exposition managers came from the association business or were tied in with that business or the show was run by an association. Associations had control a few years ago. They lost control in certain areas for this reason: the inability to change, to adapt, or to innovate quickly. However, entrepreneurs, show-management companies and publishers could act quickly and they did. They saw segmentation. They saw fragmented markets and they reacted fast and started a show. They saw a show become giant and then pulled out a segment to start another show. If you don't think that can happen, just sit around, don't pay attention to your market and watch your show go down the tubes."

In my own trade show experience, this point was abundantly brought home to me at the time of the 1973 Arab oil embargo. In

1973, the Society of Petroleum Engineers, the American Association of Petroleum Geologists, and the Society of Exploration Geophysicists were organizing some 15-18 oil industry-related expositions a year. In 1976, with the emphasis on petroleum exploration and production created by the embargo, there were more than 30 oil expositions being held. Virtually all of the new events were launched by for-profit exposition organizing companies. In 1987, at a time when the oil industry is experiencing an unprecedented economic downturn, there are only 17 significant oil expositions scheduled and all but one of them are sponsored by industry associations.

This anecdotal evidence indicates that the for-profit expositions will justifiably pull out of an area when the economics dictate. On the other hand, the not for-profit trade show will continue, in good times or bad.

The recent report of the U.S. General Accounting Office to the Joint Committee on Taxation on "Competition Between Taxable Business and Tax Exempt Organization" states: "The data suggest that income-producing or commercial type revenue has always been a major component of overall tax exempt organization revenue." There is no doubt that trade show income is an indispensable and growing part of the financial well being of associations. Since many of the activities of an association are not financially self-sustaining, the commercial activity of trade shows help underwrite such diverse activities as the educational, public information, scholarships, safety and industry standard programs which don't have a measurable dollar return and more often than not, constitute a significant dollar cost for an organization.

In the case of my own association, the Society of Petroleum Engineers, some 60% of our total revenues are generated by our meetings and exposition programs. Additionally, we manage the Offshore Technology Conference, which for more than a decade has been one of the foremost exhibitions in the world. The Offshore Technology Conference is jointly owned by 11 engineering societies. Proceeds from this world-renowned event held annually in Houston, Texas help to fund these associations. It goes without saying that the exposition programs are an integral part of all of these associations' basic program and are consistent with the tax exempt purposes of each of these associations.

I submit that Congress intended to shield this kind of commercial activity income from taxation. Otherwise, it would be impossible for us to fulfill our purpose of contributing to the educational and research activities that ultimately touches the life of every American. Congress intended to leave untaxed the income from a trade show produced by a tax exempt organization so long as its production is related to the organization's exempt purposes. Over the years, this income has been the subject of disparate treatment by the IRS. The passage of the Tax Reform Act of 1986 offers an encouraging development because Congress has finally provided a clear, legislative mandate to the IRS to consider this income outside the scope of the unrelated business tax. This clarity was not always present as the legislative history will show.

Prior to, and following the passage of the Unrelated Business Income Tax (UBIT) law in 1950, the IRS would on occasion challenge the tax-exempt status of an organization which sponsored trade shows. The IRS did not rationalize its activities as Congress did in passing the 1950 amendment on the basis of unfair competitive advantage of tax-free entities with their taxable competitors. Instead, the Service relied on the more traditional grounds that this income inured to the benefits of particular member-exhibitors and not to the industry generally. This inurement to members was cited often as the grounds for revocation or denial of tax-exempt status.

In the ensuing years following the enactment of the UBIT, the IRS paid only lip service to the congressional criteria that the activity in question (i.e., trade show income) be related to the organization's exempt purposes. A fact confirmed by the recent GAO Report which stated: "IRS officials said that the relatedness criterion often makes the UBIT difficult to administer because there are no concrete rules for determining relatedness of income-producing or commercial activities to an organization's exempt purpose." The IRS' failure to apply the literal language of the statutory tests provided neither consistency nor predictability to tax-exempt organizations which produced trade shows.

In 1967, the IRS issued regulations attempting to correct this problem with regard to trade show income by focusing on what constitutes "relatedness." For the first time, the Service conceded that trade shows sponsored by 501(c)(6) organizations could be related to the organization's exempt purposes when the shows stimulated demand for an industry's products. However, the IRS left two significant issues unresolved involving "selling shows," (order taking and sales) and "supplier shows" (the majority of exhibitors are non-members of the sponsoring organization).

Eight years later in 1975, the IRS issued a series of controversial revenue rulings, which determined that any trade shows that allowed sales activities would generate taxable income. The tax-exempt portion of the trade show industry immediately protested these unpopular rulings to Congress and successfully urged the Congress to specifically exempt "conventions, annual meetings, and trade shows" activities of Section 501(c)(5) and (6) organizations by establishing a "safe harbor" test to insure that trade show income would remain untouched.

As long as these conditions are met, a 501(c)(5) and (6) organization will be protected:

1) It must be conducted in conjunction with an international, national, state, regional or local convention conducted by a qualifying organization;

2) One of the purposes of the organizations in sponsoring the activity must be the promotion and stimulation of interest in, and demand for, the products and services of that industry in general; and

3) The show must be designed to achieve such purpose through the character of the exhibits and the extent of the industry products displayed.

One last anomaly remained to be corrected. The 1976 legislation and the implementing IRS regulations published in 1983 only dealt with 501(c)(5) and (6) organizations. The "safe haven" protection was not available to 501(c)(3) and (4) organizations. For them, the IRS continued to use its controversial rationale contained in its 1975 revenue rulings. After repeated efforts in Congress to correct this disparate treatment, it was finally accomplished in the Tax Reform Act of 1986. (See Section 1602(b), Public Law 99-514)

It is an inescapable conclusion from studying the legislative history of the Unrelated Business Income Tax provision that unfair competition was its genesis. However, in the case of trade show income, unfair competition never entered into the reasons for congressional action because trade show income is related to the organization's performance of its exempt functions.

It is our hope that your Committee's comprehensive review of the UBIT area will consider our views.

Chairman PICKLE. Thank you. We thank the panel.

I would say first, with respect to the Fraternal Orders of Police, in both Alabama and Illinois, it seems that you're here asking for relief, not for enforcement, but relief. You want the law changed so you wouldn't be taxed for your lists.

This seems to be a kind of departure from most of the testimony we have had the last few days. It seems to me you've gone to court and you've lost your case, haven't you, Mr. Lumerman?

Mr. LUMERMAN. Mr. Chairman, yes. We are presently appealing the Tax Court decision in the Seventh Circuit Court of Appeals with regard to that issue on whether the——

Chairman PICKLE. Well, what is the difference between the cases in this area? I wonder why they ruled that you, the Police Department, would be taxed if you sold your list, and yet AARP, these other organizations, can sell their lists or put out mailings that wouldn't be taxed.

Is there a distinction between the two?

Mr. LUMERMAN. The distinction with regard to the tax on the Trooper magazine income is that the IRS and the Tax Court have looked at it as advertising, and the income is unrelated business taxable income.

Primarily, the Tax Court chose to follow the case of the *United States* versus *the American College of Physicians,* not distinguishing between the type of listings or advertising in the Trooper magazine and the type of advertising that was found in the annals of internal medicine, which was the College of Physicians publication.

The advertising in the medical journal was clearly published with the idea of selling drugs which is mainly information about new drugs to physicians; whereas, whether you call our publication listings or advertising, it is not out there to attempt to sell products to the troopers. Many of the listings only contain a name and a phone number, compliments of. There is nothing in there that really resembles real advertising. The ads are not professional in any way.

Chairman PICKLE. Well, Mr. Ducate, you stated that if the ruling holds up and you're required or rather Mr. Hodges is, to pay the tax in Alabama, it costs your association some $80,000.

How do you compute your tax? What is it based on? Is that an annual figure?

Mr. HODGES. The only accurate figure we had from the examiner, the IRS examiner, was for the first year, and it was some $20,000 in 1984, the fiscal year ending in 1985. The next year, the $30,000 plus, that was a figure that the examining agent gave us. He said the actual tabulation figure wasn't available yet.

Chairman PICKLE. Well, your tax then is $80,000 in back taxes?

Mr. HODGES. Back taxes, yes.

Chairman PICKLE. Not in one year, though.

What would be the amount of tax that you would be expected to pay for each year? $20,000, $25,000?

Mr. HODGES. I would say $25,000 to $30,000 based on this.

Chairman PICKLE. On income of a million dollars, or what?

Mr. HODGES. No, sir. We gross about $300,000 a year.

Chairman PICKLE. So out of $300,000 you would pay about $20,000 in tax, just in round figures?

Mr. HODGES. That is correct.

Chairman PICKLE. Well, that is a little bit more clear for me rather than to say that you would have to pay $80,000. I thought you meant $80,000 in 1 year. That is not correct, though.

Mr. HODGES. No, the $80,000 is for 3 years.

Chairman PICKLE. All right. Now, Mr. Crowson, I take it that most of your testimony—you listed the assertion that the business income tax is so complex and confusing that it cannot be administered, and you say that it can be administered and it is not complex. Then you said that the assertion is that the relatedness standard is so vague or so uncertain that the meaning cannot be understood, and you say that your group does understand it, it is not too vague.

You say an activity should be taxable if it is competitive—and you are saying, well, they passed the UBIT to make it competitive. And you say that the statutory and regulatory treatment of research is straightforward and that you are being taxed now and that it is being handled right.

And so on. I can go right on down the list. You do say, with respect to bookstores, that you do pay some UBIT taxes and that is broken down to show, actually, that a portion of a bookstore operation does pay UBIT taxes.

Mr. CROWSON. The University of Texas at Austin does not operate a bookstore but other universities around the country do and do pay.

Chairman PICKLE. I cannot understand you.

Mr. CROWSON. The University of Texas at Austin does not operate a bookstore but other universities around the country do.

Chairman PICKLE. Well, just bookstores in general. And you said that when we observe that tax exempt organizations which enter into partnership with joint ventures are able to just trade on their tax exemption and grow larger, you say, well, the partnership ought to be encouraged, that they do not hurt, they should really be encouraged.

Now, I take it that by and large you just think the law is satisfactory and all we need do is enforce it?

Mr. CROWSON. That may be an overstatement, Mr. Chairman, but I think by and large the law is understandable and enforceable.

Chairman PICKLE. It is understandable and enforceable? Well, our problem is that it is understandable and enforceable and yet it obviously is not being enforced very strongly because of limited personnel. These organizations have grown now from a very small number to upwards of a million. And the volume of money that is not being taxed is in excess of $300 billion.

So you have to ask yourself, if the law is just not being enforced, either the IRS does not have the manpower or it is not being carried out, commercial activity seems to be getting larger and larger instead of less and less. Now, maybe that is a good thing. I am not trying to say it is good or bad, but on the surface, if we just leave things alone, then there are not going to be any changes. It is going to get bigger and bigger and so forth. So we do need to look at it.

Mr. CROWSON. And Mr. Chairman, we would like to be a part of that. I think the whole higher education community would like to look at that.

Chairman PICKLE. I assure you, we will make you a part of it.

Mr. CROWSON. The law as applied to the universities, we believe—and I do not know that much about the growth of the other nonprofit sector—but if you look at——

Chairman PICKLE. Well, how much basic research does the University of Texas do? Do you know?

Mr. CROWSON. How much, sir?

Chairman PICKLE. How much basic research?

Mr. CROWSON. That is a difficult line to draw. The total research budget for the University of Texas system last year was about $360 million.

Chairman PICKLE. Three-hundred and sixty million.

Mr. CROWSON. For last year. We anticipate that it will be around $400 million this year.

Chairman PICKLE. That is just basic. Do we have applied research? In what quantity do we have applied research?

Mr. CROWSON. Most of the research down at the University of Texas would be quantified as basic research.

Chairman PICKLE. Well, do you classify the Applied Research Laboratory as research?

Mr. CROWSON. Out of the Applied Research Laboratory there is both basic and applied research going on, as a matter of fact.

Chairman PICKLE. Does the applied research sell their products, or is it almost exclusively research for the Navy?

Mr. CROWSON. No, sir. Most of the applied research that the University of Texas has done is done for the Defense Department.

Chairman PICKLE. Is what?

Mr. CROWSON. Done for the Defense Department, one part or another of the Defense Department.

Chairman PICKLE. Well, do you sell or do you have some contractor sales for applied research, other than to entities such as the Navy?

Mr. CROWSON. We do not sell research in the sense that I think that term might be understood, but we do have research grants from private enterprises to do what one would term applied research; yes, sir.

Chairman PICKLE. Are universities such as the University of Texas paying UBIT on transfer of technology activities involving patenting and licensing?

Mr. CROWSON. Yes, sir. We are not paying UBIT on it because those are arranged in such a way that one receives a royalty. That is not a big income producer, by the way, Mr. Pickle, at any institution.

I think all of us wish that it would produce more income than it does, but what happens is an invention is patented or otherwise protected and a license arrangement is entered into which provides for a royalty to be paid both to the university and to the inventor.

Chairman PICKLE. Can you tell me what activities the university has engaged in that are subject to UBIT taxes?

Mr. CROWSON. Mr. Pickle, the board of regents of the University of Texas system for many years has operated under a policy—you have a threshold question when an activity is about to be entered into. A possible approach is to not enter into anything that causes UBIT. That is the approach that the University of Texas has taken over the years. If it requires UBIT—and I will tell you an anecdote in a second—if it is going to cause UBIT the University of Texas would prefer not to get into it.

That has been the approach, rather than to file the forms. For example, at one of our institutions in Tyler, the Tyler Health Center, they had excess laundry capacity. The question was, why do we not use that to enhance our income and why do we not sell that excess capacity in the community. The answer from Austin was, that is an unrelated business income producer and we do not want you to get into that.

Chairman PICKLE. So you do not pay the UBIT where you can help it because you just do not encourage those growths?

Mr. CROWSON. We try not to enter into those activities that would require us to pay it; yes, sir.

Chairman PICKLE. Mr. Flippo.

Mr. FLIPPO. Thank you, Mr. Chairman.

Mr. Lumerman and Mr. Hodges, I am familiar with the activities of your organizations, and having served in the Alabama House and Senate and working here for a number of years, I am particularly mindful of the many beneficial activities you are engaged in and the good work that is done there. It seems that this particular moment is of a very serious nature to your organizations because of the potential burden of having some taxes applied retroactively.

Let me ask either of you, if these problems of unrelated business income taxes and the possibility that the publications revenue might be taxable; has that question really ever been raised before in your organizations by either your tax counsel or your legal counsel prior to this incident of the IRS coming in?

Mr. HODGES. In 1983 the issue was raised by our national attorney who brought it to our attention at a meeting, that we should check into it. It was discussed, at least from our lodge, with a local IRS examining agent. And going on a bit farther, initially each of these years in question our accounts were audited. There were no changes. We were not charged any UBIT at that time and we were lulled into a false sense of security.

Mr. FLIPPO. You know, I am sure you are aware, probably, that other organizations who have incurred complaints or questions have examined the possibility and in some cases have placed these types of activities in separate spinoff organizations in which they were either a minor partner or in which they had no ownership but license.

For instance, we had testimony today of organizations who license that operation. Have you ever looked at the possibility of putting these publication revenues in some other? Because, in fact, the royalties from such a measure would not be taxable to your organizations, would they?

Mr. LUMERMAN. Well, in fact, the income now is in the nature of royalty income. We are going back to 1976 with regard to the Illinois trooper organization and the court case covers the years 1976 through 1981. I even think beyond that. We have got a new publisher and they publish the magazine. It is termed royalty income. However, we have asked for a letter of ruling from the IRS with regard to this royalty income and we have not gotten anything to date.

I am not quite sure that we will get a favorable ruling from them, or they may come in and audit and say that this is still unrelated business income and subject to taxation.

Mr. FLIPPO. Mr. Hodges?

Mr. HODGES. We have also changed our contract in a like manner and our attorney advises us the very same, that it may not hold water at all as far as the opinion goes.

Mr. FLIPPO. I am sorry. Perhaps I did not understand your response.

Mr. HODGES. I said our attorney advises us, even with the changes we have made, that there is certainly no guarantee that it will stand up to IRS. We have also asked for an opinion if it would, and so far we have not got an answer.

Mr. FLIPPO. Well, just one final question. Do you see any difference in the revenue that your organizations receive in this situation and one in which spinoffs are producing royalty incomes and are not taxable to those entities? Is there any basic difference between what you are doing and what some others are doing except the form under which others are doing it?

Mr. LUMERMAN. Well, in this case, no, there is no basic difference. One of the issues in the Tax Court was whether or not it was royalty. The Tax Court ruled against us in that regard. Frankly, because of the way it is done, it possibly will not prevail in the Seventh Circuit either.

Mr. FLIPPO. Well, I just want to say that I am certain that no member of this committee wants to see the fine services your organizations render not rendered because they are very worthwhile and we hope the matters can be resolved.

Mr. HODGES. May I make one additional comment?

Mr. FLIPPO. Yes.

Mr. HODGES. This was noted in the decision in the Illinois case, Judge Shields in his written opinion alluded to the fact that there is no definition of advertising in the Tax Code. I think that this is something that I would encourage you on the committee to look into, is attempting to get a definition of advertising in the code itself. We have done a complete flip-flop from not being considered advertising at all to being totally, regardless of what form the ad—if that is what you want to refer to it as—as to all of them are definite advertising on parity with newspapers, yellow pages, what-not. It has gone just from black to white in the opinion of the examining agent.

Mr. LUMERMAN. May I add my concurrence with that. In fact, the regulations do state commercial advertising is an unrelated business and the income therefrom would be taxable. The code does leave that definition in the air, and the regulations do not state what commercial advertising is. The Supreme Court in their decision talked about commercial advertising without specifically giving us what they felt it was.

I think these types of publications—the Trooper magazines, other in-house publications—our Trooper magazine, I think there are 3,000 published at one time, and I assume that the Alabama Trooper is less than that. They are not aimed to promote the sale of products to anybody. They are in-house organs used to disseminate information, and to state that this is advertising is really a mistake.

Mr. FLIPPO. Well, I thank the gentlemen for their testimony.

Chairman PICKLE. Mr. Ducate, you said that there is no problem with the Internal Revenue Service auditing your publication, you get good attention. How often has your or your type of publication organization been audited in recent years?

Mr. DUCATE. My comments, sir, were directed towards trade shows. Are you speaking as NAEM or as the Society of Petroleum Engineers?

Chairman PICKLE. Well, you say they have been audited in recent time, or often?

Mr. DUCATE. No, sir. As the Society of Petroleum Engineers, our particular publications have not been audited. But we have a for-profit subsidiary corporation.

Chairman PICKLE. Well, the tax bill of 1986 pretty much cleared up your question about whether that was income or not; did it not?

Mr. DUCATE. Under the 1986 tax bill I believe the exhibition industry is now totally clean in its relatedness to all of the not-for-profit organizations that produce trade shows.

Chairman PICKLE. All right.

Mr. DUCATE. I believe it has solved our dilemma.

Chairman PICKLE. Well, I want to thank you panelists for your testimony. We are trying to get a good cross section of organizations—nonprofits, universities, hospitals and other organizations like that.

We are going to resume our hearings now again in the morning at 9 o'clock in room B-318, so that the people would be informed about where we are going to meet.

I thank you very much for your participation and for your willingness to sit with us through the day. So thank you very much.

The committee will be adjourned then until 9 o'clock in the morning.

[Whereupon, at 3:10 p.m., the subcommittee adjourned, to reconvene at 9 a.m., Tuesday, June 30, 1987.]

○